

# **Investment and Securities Trading Simulation**



**An Interactive Qualifying Project Report  
submitted to the Faculty of  
WORCESTER POLYTECHNIC INSTITUTE  
in partial fulfillment of the requirements for the  
Degree of Bachelor of Science**

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**Date: May 1, 2011**

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**Abstract:**

**Investing in the Foreign Exchange market, also known as the FOREX market, is extremely risky. Due to a high amount of people trying to invest in currency movements, just one unwatched position can result in a completely wiped out bank account. In order to prevent the loss of funds, a trading plan must be followed in order to gain a maximum profit in the market. This project compiles a series of steps to become a successful FOREX trader, including setting stop losses, using indicators, and other types of research.**

**Acknowledgement:**

**We would like to thank Hakim Hossein, Professor, Electrical & Computer Engineering Department, Worcester Polytechnic Institute for his guidance throughout the course of this project and his contributions to this project.**

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## 1 Introduction

### 1.1 Introduction

Doing work without compensation is pointless. Giving away a product with no gain by the producer is a loss. Even in the earliest types of societies people realized this as no one wanted to work for free. Not everyone could be some sort of farmer, growing for himself. This problem established a trade system that would allow people to trade some sort of goods for another, making it possible for farmers to specialize in a smaller number of products to give other farmers in exchange for what they specialized in.

It could be determined that one of the first types of currency was any good that could be exchanged for another. This currency exchange within a society is called economy, and every modern day country has one. Over many years it became international as well. The first government to implement an economy was the Babylonian government. They developed the first record of some debt laws and private property. It wasn't until several centuries later that they expanded their record to show debt and payments up to date as well as the invention of an inventory and keeping records of such inventory. This was taking place around 2600 BC. The same government implemented laws about dividing property and interests on debt, as well as rules on monetary compensation for property damage or physical damage to a person. They also instituted fines for people who would act out of line, as a sort of punishment that in present day still exists as a fine or infraction.

The next step closer to what we call a modern economy happened in the Middle Ages. Many more forms of exchange started to come about, closely related to those modern ones. Most exchanges happened between a social group. Conquerors also raised venture capital to aid with the military at the time and protect their own. Once they conquered a new land, the good from that area would cover the deficit created by taking over. It was around this time as well that the first banks were founded by as Jakob Fugger (1459–1525) and Giovanni di Bicci de' Medici (1360–1428). Global economy was founded after the discoveries of Marco Polo (1254–1324), Christopher Columbus (1451–1506) and Vasco da Gama (1469–1524). Economy at the time meant primarily trade.

Once all these discoveries were made, the areas captured became colonies of Europe as the rise of nations like Spain, Portugal, England and the Netherlands began to emerge. These nations then started controlling the trade with custom duties and taxes to protect their national economy. Once these countries were established they needed finance and bankers such as Amschel Mayer Rothschild (1773–1855), who started to finance national projects such as wars and infrastructure. From then on, a modern definition of economy came about.

Countries then kept appearing and now were desperate for a way to control the incoming and outgoing markets of their own. People needed a way to buy something in another country but make sure they did not get cheated. The solution was an exchange rate, this compares two different international currencies and based on the current economy of those countries gives a ratio of how much one currency is equal to the other in its own terms.



To be able to control these exchange rates, banks all over the world started sending data internationally over a computer system that allowed exchange rates to fluctuate based on current national and global economy. The system that allows individuals and countries alike to buy and sell currency is called Forex, or Foreign Exchange.

Forex is a market dedicated to the trade of currency around the world; it has many unique features that separates it from the well known New York Stock Exchange market. For example, it has a very high volume that leads to high liquidity. An estimated \$3.21 trillion get turned over every day, and the total market volume is estimated to be \$3.98 trillion. Another advantage of trading in Forex is the leverage, which means that one can buy up to 100:1, so to manage an account with \$100,000 with a margin of 1%, someone would only need \$1,000 in an account. This market also operates 24 hours a day with the exception of weekends.

The way the Forex market works is by trading a currency against another in a pair. The most common pairs include: EUR/USD, USD/JPY, GBP/USD, AUD/USD, USD/CHF and USD/CAD.

Forex has developed over the years to be the global standard for trading, and events all around the world will affect the market. For example, a strike in a country that produces and exports corn will have a very large drop in the exchange rate of corn against other countries. This is where a person or bank will want to try and sell that currency against a stable or rising currency and make a profit. The goal of Forex trading is to profit from the moving foreign currency.

Forex traders can make very large profits off a single investment, but there are also risks which include exchange rate risks, interest rate risks, credit risks, and country risks. Around 80% of all currency trades occur in less than a week, with 40% of all trades opening and closing within two days. Due to the short lifespan of trades, the best way to trade this market is with technical indicators which give a good estimate for entry and exit point. Nothing beats good investing experience, as well as a good intuition and a solid trading plan.

There are many types of indicators, and testing them is very important before putting them into use. The most common type of indicators include: Bollinger Bands, MACD, Parabolic SAR, Stochastic and relative strength index. Throughout this project these indicators will be tested and proposed results will be shown.

## **1.2 Project Description**

The purpose of this project is to test various methods of investment. This was done by using different indicators. Indicators were used one at a time or with a combination of two or more at a time. Although there is no single way to make money guaranteed in a market such as Forex, using a designed method to trade money can result in smaller losses. In this project different platforms were used, in order to compare how user-friendly they can be.

## 2 Background

### 2.1 History of Forex

Dating back to before biblical times, people have been trading with each other for goods that they do not have or that they wanted to resell for profit. These ancient traders sold and bought livestock, precious metals, crops, and anything that they could get their hands on. This small trade continued throughout the centuries, and then nations started developing. These new nations all used different currencies, and trading with different currencies got a bit complicated. From this, foreign exchange was born, although a formal global market for foreign exchange did not develop until the 1800's with cable transfers taking place between London and New York. Trading with the different currencies meant that the two currencies had to be compared for value and some currencies were worth more and some were worth less. The fluctuation of values caused trades to go up and down with the trends and caused a need for a central market.

The modern day FOREX history started in 1875, when the gold standard was put in place. Before this, countries used gold and silver as international payments. When new deposits of gold and silver were found though, the value of the precious metals would cause the countries to lose value and this changed with supply and demand all the time. Due to the

instability of the precious metals, something had to change. The purpose of setting this gold standard was to make sure that currency was guaranteed by gold or silver. Countries now needed large gold reserves to back the currency. The exchange rate became the difference in an ounce of gold between nations. The gold standard fell through at the start of World War I, when political turmoil with Germany made the Europeans focus on the structure and shaping of the military. There was a sudden lack of gold as there was an excess of currency, and this again changed the standard of exchange rates. The lack of gold caused the abolishment of the gold standard, and this matter tended to by the Allied countries. A convention was held at Bretton Woods, New Hampshire, in July of 1944, to solve this problem. This convention led to the inception of the "Bretton Woods monetary system". This system proposed that a new method of obtaining a fixed foreign exchange rate was needed. The gold standard was to be replaced with the US Dollar as the ultimate exchange currency. The US Dollar was to be the only currency that was still backed by gold and three international authorities guarded over all foreign transactions. This monetary exchange system lasted about 25 years and failed primarily because the US Dollar was the only currency to be backed by gold. The U.S announced the end of the exchange of gold for US Dollars by foreign banks in August of 1971.

In the past, governments attempted to set exchange rates themselves to improve a country's trade position. When an exchange rate is set low in comparison to other countries, it makes the exports more affordable and imports less affordable. This improves a countries position in the market. These changes in exchange rates caused frequent "trade wars", where countries would compete to get the best rate. Since the 1970's, countries' exchange rates depend on the supply and demand, called "floating". Although it is semi-controlled, most

countries keep a reserve of gold or foreign currencies in case of crisis. The buying or selling of these reserves can control the movement of a currency.

Today, countries can choose from many types of exchange systems. A free floating exchange system, as was mentioned before, permits the market, instead of a country, to establish the price of a currency. Many factors both technical and fundamental affect the exchange rates, and would all be able to occur regardless of their effects on the currency. A pegged exchange rate like the Bretton Woods system would work like the original gold standard, with currencies being linked. A central bank can also buy a specific amount of the domestic currency, in times of deficit, in return for its foreign currency reserves. This brings back the price of the currency to its original value but also at the same time depletes the amount of its currency reserves.

Once a world economy had emerged there was a need for foreign exchange. Rather than exchange currencies, countries would trade Gold, since gold was used by most of the major countries. The Gold Exchange Standard, which was the international standard for trading from 1879 to 1934, had a fixed value of gold for all of the major currencies. Since all the currencies had a fixed value associated to them the rate of exchange was fixed between each country. For example the Japanese Yen was worth 36 grains of gold and a U.S. dollar was worth 12 grains of gold, then the Yen would have had three times the value of a U.S. dollar, fixing the exchange rate at 3 dollars for each dollar Yen. One key requirement was that the countries adhering to the gold standard needed to maintain their money supply to a fixed quantity of gold, so the government could only issue more money if it had obtained more gold. This requirement was

to prevent countries from just printing money to pay foreigners and to ensure that every bill had a gold backing.

This system was effective for a while, but several flaws were revealed once international trading started to expand. At the beginning of World War II many European countries needed more currency to fund their war efforts. However, they did not have the gold backing that was required to acquire the amount of currency they needed. The main problem with the gold standard was that if a country was not competitive in the world marketplace, it would lose more and more gold as more goods were imported than exported. With a depreciated supply of gold, the country was required to reduce their money supply, which would hurt the country's economy. Less money in circulation reduces employment, income, and output. Another major flaw in the gold exchange system was gold was heavy and difficult to transport across the oceans from country to country.

The gold standard finally collapsed during the Great Depression of the 1930's. Countries started to abandon the gold standard by devaluing their currency. Countries began reducing the amount of gold backing their currency so that they could increase their money supply in an attempt to stimulate their economies. When some of the countries abandoned the gold standard it collapsed because it was a system that could not work unless all of the trading countries complied with it.<sup>1</sup>

The leaders of the allied nations met in Bretton Woods, New Hampshire in 1944, to set up an improved system of fixed exchange rates. The U.S. dollar was fixed at \$35 per ounce of

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<sup>1</sup> [http://thismatter.com/money/forex/foreign\\_exchange\\_history.htm](http://thismatter.com/money/forex/foreign_exchange_history.htm)

gold and all other currencies were valued in terms of the US dollar. This official fixed rate of exchange was known as the par value of currency. Nations also agreed to buy and sell U.S. dollars to keep their currencies within 1% of the fixed rate.

The Bretton Woods system began to weaken in the 1960s, when foreigner nations accumulated large amounts of U.S. dollars from post World War II aid and from sales of their exports in the US. There were concerns as to whether the U.S. had enough gold to back all the dollars. At the time Fort Knox only contained a third of the gold necessary to cover the amount of dollars in foreign hands. With reserves of gold falling, the system could not be sustained and the U.S. decided to abandon this system. In 1971, President Nixon announced that U.S. dollars would no longer be convertible into gold, so the exchange rate was allowed to float and the Bretton Woods system was ended.<sup>2</sup>

The next system introduced was called the Managed floating exchange rate, which is the system that exists today, is a rate that mostly floats. A country can sometimes manipulate their exchange rate through their central banks. If a country wants to implement a change it is usually done by buying or selling the currency that the country wants to influence, and thereby influencing supply and demand. Many smaller countries fix their exchange rate by pegging their currency to the United States dollar to try and stabilize their currency.

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<sup>2</sup> <http://www.time.com/time/business/article/0,8599,1852254,00.html#ixzz1DwrcSuur>

The major benefit of the Managed floating exchange rate is that it corrects imbalances automatically. If a country imports more than it exports, its currency will decline in relation to the importing country's currency, which will make imports more expensive and exports less expensive. This will reverse the imbalance. A floating exchange rate allows for the exchange rate to mirror the strength of a country's economy. For example, if a country experiences a significant recession or boost in their economy their currency will weaken or strength corresponding to the strength of that country's economy. This opens up the ability to trade based on country's fundamentals. Another major benefit of the floating exchange rate is that it allows countries to manage their own economies through monetary policy. For example, a country can expand their money supply to try and stimulate the economy, or contracting its supply to reduce inflation. Since countries can manipulate their foreign exchange rate the publication of significant changes in monetary policy, such as the raising or lowering of interest rates by the major countries can increase volatility in its currency, both before and after the news is published. This opens up the opportunity for traders to trade news releases. The current system makes it easy for countries to exchange money at a fair rate and is a great opportunity for investors to profit from the volatility of currency correlations.

Leverage is a very important aspect of forex trading and is one of the reasons why trading the foreign exchange market is so appealing. Leverage is a loan that is provided to an investor by the broker of a forex account. Currently, leverage is limited to 50:1. This means that for every 1 dollar invested then transaction is multiplied by 50 dollars. If a person were to trade 1 lot of USD/EUR, which is equal to US\$100,000 the margin required would be US\$2,000. Forex is very appealing because it offers a much higher leverage than the other trading markets



such as futures. A person who only has \$2,000 to invest might not be able to purchase enough stocks to have a well balanced portfolio but they would be able to trade forex because the 50:1 leverage allows them to trade 1 lot of currency. With leverage, traders are given a better chance of a much higher return. However, it should be pointed out that leverage works in both directions. While you can earn a lot of money very quickly by making winning trades, you can also lose money very quickly when in a losing position because of leverage. It is very easy to potentially lose all of your capital because of an over leveraged position. This makes it extremely important to calculate the potential losses of a position and to have a stop loss in place in order to prevent excessive losses.

To obtain an even better edge while trading, investors research how a corporate structure is built in order to learn about the fluctuation of money. This in turn provides an opportunity to follow trends after certain news reports that affect companies in a nation.

## **2.2 Introduction to Corporate Structure**

When starting a business, it is important to consider the different ways in which businesses can be structured. Whether it is a sole proprietorship, partnership, or a corporation, each business type offers certain advantages and disadvantages. For example, a sole proprietorship is fairly simple to establish, and offers favorable tax advantages. An example of this type of business is any owner-operated business, such as a barber shop or corner store. This is typical of small businesses and the main disadvantage with this type is that it is limited by the sole proprietor's resources. The resources are limited in terms of knowledge, experience, and skills as well as in financial resources. The obvious solution to this is to

establish a partnership, where two or more partners pool their money and talents and can thus achieve more effective operations and at a larger scale than a sole proprietor could. However, each partner is equally liable for the company's debts, and can be personally sued should anything go wrong. To avoid this problem, many businesses become incorporated.

A corporation is a separate legal entity, created by law in a state of its own choosing, and has most of the rights that any person would have. A corporation is entirely separate from its owners and acts under its own name rather than in the name of its stockholders. It can buy, own, and sell property. Corporations can also borrow money and enter into legally binding contracts. It may also sue or be sued, and it pays taxes as a separate entity. Corporations issue stocks, or shares in the company, which are transferrable units that can be bought or sold freely, thus transferring ownership in the company. It is important to note that transfer of ownership rights among stockholders normally has no effect on the operating activities of the corporation, nor does it affect the corporation's assets, liabilities, and total stockholder's equity.

A corporation has a number of advantages over more traditional business forms. It is relatively easy for a corporation to acquire capital through the issuance of stock, as long as the stock is bought. Buying stock in a corporation is often attractive to an investor because a stockholder has limited liability and shares of stock are readily transferable. Numerous individuals can become stockholders by investing small amounts of money, which can also be appealing to an investor. Another advantage is that a corporation can have a continuous and perpetual life as its existence does not depend on the natural life of any stockholder,

employee, or officer. The life of a corporation can sometimes be limited to a specific number of years in the company's charter, but the charter can also be renewed, making it everlasting. The company's charter describes the name and purpose of the corporation. The charter also describes the types and number of shares of stock that are authorized to be issued. It contains the names of the individuals that formed the company, and the number of shares that these individuals agreed to purchase. It also contains bylaws which establish internal rules and procedures for conducting the affairs of the corporation. Corporations are free to engage in interstate commerce, but they must first obtain a license from each state in which they plan to do business. Regardless of the number of states in which a corporation does business, it can only be incorporated in one state. Because of this, it is important to choose to become incorporated in a state with laws and tax codes favorable to corporations.

The way a corporation is managed is also unique among business forms. In a corporation, the stockholders manage the company indirectly through a board of directors they elect. The board then formulates the operating policies and selects officers to perform essential management functions. The chief executive officer, or CEO, has overall responsibility for managing the business. Also, the chief accounting officer is the controller, meaning he is responsible for maintaining accurate accounting records, maintaining an adequate system of internal control of funds, and for preparing financial statements, tax returns, and internal reports. The treasurer has custody of the corporation's funds and is responsible for maintaining the company's cash position.

Because of a corporation's unique status as an independent entity, it is subject to additional government regulations. At the federal level, there are federal securities laws which govern the sale of capital stock to the general public. There are also state laws that prescribe the requirements for issuing stock, the distributions of earnings permitted to stockholders, and acceptable methods for retiring stock. In addition, publicly held corporations are required to disclose their records of financial activities to the Securities and Exchange Commission, or SEC. Also, when a corporation is listed and traded on an organized securities exchange, it must comply with the reporting requirements of these exchanges. Corporations are required to pay taxes as a separate legal entity in a high tax bracket, sometimes as high as 40% of taxable income. In addition, individual stockholders are taxed on dividends they receive from the corporation, creating a situation known as double taxation. This means that the income received by the corporation is taxed twice; once at the corporate level and again at the individual level.

Holding stock in a corporation has many advantages. For one, owners of common stock are able to vote in elections naming the board of directors, and are also allowed to vote on actions that require stockholder approval. Stockholders are entitled to a share of the corporate earnings through receipt of dividends. They are also usually granted the option of buying more stock when new shares of stock are issued in order to maintain their same percentage ownership. This is called preemptive right. Finally, stockholders are entitled to their share of assets upon liquidation in proportion to their holdings. This is called residual claim because owners are paid with assets that remain after all other claims have been paid.

### 2.3 Corporate Finance

One of the advantages a corporation enjoys is the ability to raise capital with relative ease.

There are five major ways corporations raise money:

- Issuing bonds
- Issuing preferred stock
- Selling common stock
- Loan
- Using profit

Issuing bonds is the preferred way for the corporations to raise capital. A bond is a written promise to an individual, a company, or a government that the corporation will pay back the borrowed capital at a specific date or dates that they agreed on with a predetermined interest rate. It is the preferred method to raise capital because the interest that the corporations owe to the bondholders is comparably lower than other methods such as loans from the bank. Also, interest paid to bondholders is considered a tax-deductible business expense.<sup>2</sup> Corporations are required to pay bondholders their interest even if the company is not making any profit.

Preferred stock is stock that a corporation releases when it is in financial danger. Buyers of this stock have special rights over common stock holders that give them preferred status, meaning their dividends are paid after the bondholders get their interest, but before the common stockholders. For example, if the dividend rate on preferred stock is 5 dollars per share, common shareholders will not receive any dividends in the current year until preferred

stockholders have received 5 dollars per share.<sup>3</sup> Sometimes, preferred stock contracts contain cumulative dividend. This means that preferred stock holders must be paid both current year and any previous years that they have not yet been paid before common stockholders get their dividends.<sup>3</sup> However, some preferred stocks that have not been declared in a given period of time are considered not liable. No obligation exists until the board of directors formally declares that the company will pay dividends.

Selling common stock is the most convenient and most commonly used method for the company to raise money. This type of buying and selling is much different than the buying and selling people experience on a day to day basis. The company must first issue stocks before the public can buy them. Regarding the issuing process, the company must get the authorized stock. Authorized stock is the amount of stock that a corporation is authorized to sell as indicated in its contract. The company must get permission from the state of incorporation in order to change the contract if they have sold all the authorized stock and want to sell more. When the authorized stocks are obtained, the company can issue stock in two different ways, either indirectly or directly.<sup>3</sup> A company can issue common stock directly to investors, or they can issue indirectly through an investment banking firm that specializes in bringing securities to the attention of prospective investors. Selling common stock is a reliable and an easy way for a corporation to raise the capital. Even though it is selling the ownership of the corporation to the public, it's a good money making method without high risk for the corporation.

Getting a loan from a bank is another method for a company to raise capital, but it is not usually preferred due to high interest rates. Generally speaking, a corporation will not

borrow money from a bank unless it is in a financial crisis or they have no other way of raising the capital.

Companies also use their income to raise more money. Some companies use 50 percent for expansion and other necessities and use the other 50 percent of the income to pay dividends to the stockholders. Some companies, usually small ones, reinvest all their net income back into research and expansion of the company hoping to pay rapidly increasing dividends to the stockholders.

Business incubators are programs designed to accelerate the successful development of entrepreneurial companies through an array of business support and services through network contract.<sup>1</sup> Some small companies look into business incubators—a business park with new starting companies. They take advantage of reduced rent and minimize start-up cost by sharing with other small corporations. This is indirect way of raising capital, because incubators often attract many investors looking for new potential corporations. These business incubation programs are not open for anyone. Corporations who wish to join must apply for admission. Normally, corporations with reasonable potential ideas are admitted to the program.<sup>1</sup> Many investors have positive reactions toward the business incubation program since historically speaking, 87% of the corporations started from incubation program managed to stay in business.<sup>1</sup>

## 2.4 Stock Market Basics

It is important to have a basic understanding of the stock market before trying to grasp some of the more complicated concepts that are associated with investing in the stock market. When an investor buys stock in a company they are essentially taking ownership of a very small portion of the company. As a shareholder, you technically own a very small piece of everything that the company owns. However, just because you are a shareholder, it does not mean that you have a say in how the company is managed. A shareholder can vote to have the management of a company removed. In order for this to happen, a shareholder must have control of a large amount of stock in the company before they have any influence on the management of the company.

For the most part, shareholders are more interested in other benefits than investing in stock offers, because they won't be buying enough stock to have a real impact on the management of a company. Actually, most shareholders are not at all interested in managing the company that they invest in; they are more interested in capitalizing on the fluctuation of the stock's price. A stock's price is based on supply and demand. "If more people want to buy a stock (demand) than sell it (supply), then the price moves up. Conversely, if more people wanted to sell a stock than buy it, there would be greater supply than demand, and the price would fall."<sup>3</sup> An investor must take both the strength of the company and the performance of the stock into account. A company might be showing signs of large earning growth, but at the same time have a stock that is not performing well. This is because investors have not yet noticed the potential of this company and the demand is low for its stock. However, if the

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<sup>3</sup> <http://www.investopedia.com/university/stocks/stocks4.asp>



company continues to perform at a high level, investors will take notice. As a result, the demand for the company will eventually grow, along with the stock price.

On the contrary, a company might have a stock that has a high demand among investors, but if the company does not have a strong business strategy to maintain their high earnings, the demand for the company's stock will be lost and the price will dive. In essence, an investor isn't just evaluating a stock for its current price, they are making an evaluation of how they expect the price of the stock to fluctuate and change in the future, in order for them to make a profit.

Stock exchanges are places where buyers and sellers come together and make trades. The two major stock exchanges in the US are the New York stock exchange and the NASDAQ (National Association of Securities Dealers Automated Quotations) stock exchange. A stock exchange can have a physical location or be can be electronic. For example, the New York stock exchange is located on Wall Street in New York City, and the NASDAQ stock exchange is an electronic exchange where trades are completed over the computer.

In the past, a person buying stock would do so through a broker. A broker is a person that buys and sells stocks on behalf of an investor. A broker can offer advice to what moves to make, but ultimately the final decision is left to the investor. However, with the increase in technology over the past decade, a broker is no longer necessary for an individual who wants to invest. There are many online trading platforms available like E\*trade, Ameritrade, or tradestation. These platforms are usually cheaper than paying a broker commission and usually offer lots of customizable tools that allow an investor to do their own unique research.

Each investor has a unique strategy for evaluating a stock's potential. Many investors look at various financial reports and statements that companies are required to release in order to try and predict the company's future stock value. A strong report can motivate an investor to buy stock because they think the company's stock price will rise in the future. This is called a microeconomic perspective, or the belief that the individual company's performance has the most influence over the price of its stock.

Another perspective is called a macroeconomic perspective. It is the belief that "share prices are influence by three broad factors: the general performance of the economy, including changes in interest rates, inflation and real economic growth, the performance of a given industry, and the quality of a management in a specific firm."<sup>4</sup> This belief is why many experts recommend having a diverse portfolio, or a collection of stocks from different industries. Having a diverse portfolio will protect your investments. If an industry is struggling, only one of the stocks in your collection will be negatively affected. Basically, if you invest in several different industries, the probability that they will all fail at the same time is lower than if you invest everything in one industry.

An important chart to be able to read and understand is a stock table. It offers an opportunity to scrutinize your stock's performance in comparison to the performance of others. Below is an example of a stock table that can be found in many newspapers such as *The New York Times*.<sup>5</sup>

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<sup>4</sup> Putnam and Zimmer, *The Blackwell Guide to Wall Street* (New York: Basil Blackwell Inc. 1987),Pg. 41

<sup>5</sup> <http://www.disnat.com/en/knowledge/stocks/stocks6.asp>

52W high	52W low	Stock	Ticker	Div	Yield %	P/E	Vol 00s	High	Low	Close	Net chg
545.39	19.75	ResMed	RMD			52.5	3831	42.00	39.51	41.50	-1.90
11.63	3.55	Revlon A	REV				162	6.09	5.90	6.09	+0.12
77.25	55.13	RioTinto	RTP	2.30	3.2		168	72.75	71.84	72.74	+0.03
31.31	16.63	RitchieBr	RBA			20.9	15	24.49	24.29	24.49	-0.01
8.44	1.75	RiteAid	RAD				31028	4.50	4.20	4.31	+0.21
538.63	18.81	RobtHalf	RHI			26.5	6517	27.15	26.50	26.50	+0.14
51.25	27.69	Rockwell	ROK	1.02	2.1	14.5	6412	47.99	47.00	47.54	+0.24

*Figure 2.1: standard stock chart*

Column 1 and 2 display the 52 week high and low prices. These are the lowest and highest prices that the stock hit in the past 52 weeks. The ticker is the abbreviation that is used as the stock's symbol. Column 5 shows the dividend, which is the annual payment per share to the companies' shareholders. Not all companies offer a dividend with their stocks, which is why there are not entries in every row. The yield percentage is calculated by dividing the dividend by the stock's current price. The P/E is called the earnings multiple. It is a ratio of the stock's price to the companies' earnings. The volume is the number of shares that were traded on that particular day, and in this particular table the numbers were multiplied by 100. Columns 9 and 10 are the high and low price that the stock reached on that particular trading day. The Close column is the price that the stock finished at after the end of the trading day. The net change is the actual dollar change from the previous day's closing price. All of this information is readily available in most major newspapers or online, and can provide a lot of information to aid with stock trading.

By having a core understanding of the basics of the stock market, an investor can begin to hone their skills and learn the finer details that are involved with investing in the stock market. Many people feel overwhelmed by the figures and statistics that many experts use. By

establishing a basic understanding of the market and the figures themselves, it becomes easier to understand some of the more complicated strategies that the experts use daily.

## 2.5 Currency Parings:

Currency Correlations are extremely important in understanding when trading Forex. Some currency pairs move in tandem and some move in the opposite directions. Basically, currency correlations measure how much a currency pair moves in relation to another currency pair. These correlations are measured on a scale from -1 to 1. Two currency pairs are rated as a -1 that means they move in opposite directions 100% of the time. If the pairs are rated at a 1 they move together 100% of the time. A rating of 0 means the two pairs move in a completely random relationship to each other. Currency correlations are not set in stone and often change from month to month and need to be checked often. Below is a picture of a currency correlation chart:

NZD/USD	EUR/USD	AUD/USD	USD/JPY	GBP/USD	USD/CHF	USD/CAD
1 Month	0.84	0.93	0.76	0.86	-0.81	-0.72
3 Month	0.69	0.92	0.09	0.71	-0.77	-0.63
6 Month	0.66	0.88	-0.42	0.22	-0.84	-0.73
1 Year	0.96	0.99	-0.57	0.86	-0.97	-0.96

USD/CHF	EUR/USD	AUD/USD	USD/JPY	GBP/USD	NZD/USD	USD/CAD
1 Month	-1.00	-0.72	-0.40	-0.95	-0.81	0.28
3 Month	-0.96	-0.84	0.31	-0.88	-0.77	0.35
6 Month	-0.90	-0.78	0.50	-0.52	-0.84	0.52
1 Year	-0.97	-0.97	0.63	-0.87	-0.97	0.95

USD/CAD	EUR/USD	AUD/USD	USD/JPY	GBP/USD	NZD/USD	USD/CHF
1 Month	-0.31	-0.80	-0.70	-0.35	-0.72	0.28
3 Month	-0.18	-0.57	-0.44	-0.11	-0.63	0.35
6 Month	-0.22	-0.82	0.36	0.11	-0.73	0.52
1 Year	-0.90	-0.97	0.58	-0.88	-0.96	0.95

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*Figure 2.2: Currency Correlation chart*

It shows which pairs have strong correlations and which ones have a negative correlation over several different time periods.

Knowing currency correlations can help you several ways. First, it can help you to avoid entering two positions that have a negative correlation and will just cancel each other out. Or it can help you if you enter into two positions with similar correlations. It can also help you hedge risk. For example if you enter into a position and want to reduce the risk of loss, you can also enter into a position with a pair that has small negative correlation to the first position. That way you have a hedge set in place if your trade does not move the way you want it to. Unfortunately, this method also results in smaller profits too.

Some countries' currencies will have a correlation because of the countries proximity or because they participate in a large amount of trades with each other. For example, USD and

<sup>6</sup> <http://www.investopedia.com/articles/forex/05/051905.asp>

CAD have a strong correlation because the US gets a large supply of oil from Canada. As a result, the price of Oil and the USD/CAD pair often trade at very close correlations.

## 2.6 Choosing a Trading Platform:

A trading platform is software through which traders can place orders and manage their open positions. Trading platforms are offered by brokers either for free or at a discount rate in exchange for maintaining a funded account and or making a specified number of trades per month. These platforms allow for electronic trading that can be accessed anywhere there is an internet connection opposed to trading on the floor of a stock exchange or over the phone. Brokers often provide certain services and trading tools to their customers to try and get traders to use their platform. Most brokers will allow traders to open a demo account so that they can test out the platform and hone their trading skills. The parts of a trading platform usually consist of a charts window, an area to place new orders as well as monitor your open positions, some offer economic news calendar as well as live news feed. Most platforms offer a market watch area where you can monitor the current bid and ask prices of many different currency pairings. Additionally, some platforms allow you to join live video sessions with a trading advisor who will train you to be a more efficient and effective trader.

When choosing a platform there are several factors that a trader should consider before selecting one. You must consider what fees, if any, are associated with each platform. Another factor that must be considered is the technical indicators that are offered by each platform. Additional services some platforms offer are training seminars or videos with investment experts as well as specialized indicators that are created by the investment experts.

Some platforms allow you to backtest your trading strategy to see how successful it would have performed over a period of time. This is a very useful tool to show how effective your trading strategy will be in the future. Other factors to consider when choosing a platform are the types of market orders that the platforms offers and whether or not the platform allows you to trade directly from their charts. When looking for a platform, you want to make sure the platform you choose offers all the tools that it takes for you to be a successful trader.

## 2.7 Trading Indicators

Indicators provide a means of organization in an otherwise chaotic currency market. For an indicator to work, raw data is taken as the basic input and manipulated to create an output of an actionable trading scenario. These indicators include a wide variety of categories, such as oscillators, Larry Williams indicators, moving averages, momentum indicators, volatility indicators, volume indicators and many others. Due to the nature of an indicator being based on previous data, it is not a predicting tool. The best application of an indicator is to give order to the price data to outline possible winning opportunities for the investor. One can never say an indicator is wrong or right, but each must be used in a way that uses that data in an appropriate money management strategy to maximize the results. The amount of indicators always keeps growing. It is hard to say exactly how many there are because it is not difficult to define a new tool to evaluate the market, as long as one has a basic understanding of what an average is and what the final goal of the indicator will be (Forex Indicators). "So you can regard indicators as your compass and ruler in navigating waves of the Forex market. We would use a compass or a ruler to predict when or where a storm will hit, but every sailor knows their usefulness in defining a path over the high seas," (Forex Indicators par. 3) Before we look at the

various indicators that are popular in forex trading we will first look at some common indicator patterns so that we have a basic terminology and an idea of the types of signals indicators produce.

### 2.7.1 Indicator Signs

There are several patterns that are produced by indicators such as overbought, oversold, divergence and crossover. An important sign given by an indicator is the overbought signal. This is produced when the demand for an asset pushes the price to a point at which the value of the asset is unfounded and unjustified. Essentially the demand causes the price to rise to a point at which the asset becomes overvalued.<sup>7</sup> It is important to identify when this occurs because the market will eventually correct itself and pull back to a more appropriate level. In momentum indicators that have a range from 0 to 100, overbought conditions are typically identified when the indicator crosses above the 80% level.

The oversold signal is the exact opposite to the overbought signal. This occurs when the demand for an asset drops which causes the price to fall to a level that makes it very undervalued.<sup>8</sup> The market will correct itself once again and the price of the asset will be returned to a normal value. Momentum indicators identify oversold conditions when the indicator drops below the 20% level. Many traders enter into a buy position when the indicator drops below the 20% level and then returns back above this level.

Another sign produced by momentum indicator is when the pattern diverges from the price chart pattern. When the indicator is moving in the opposite direction of the price chart

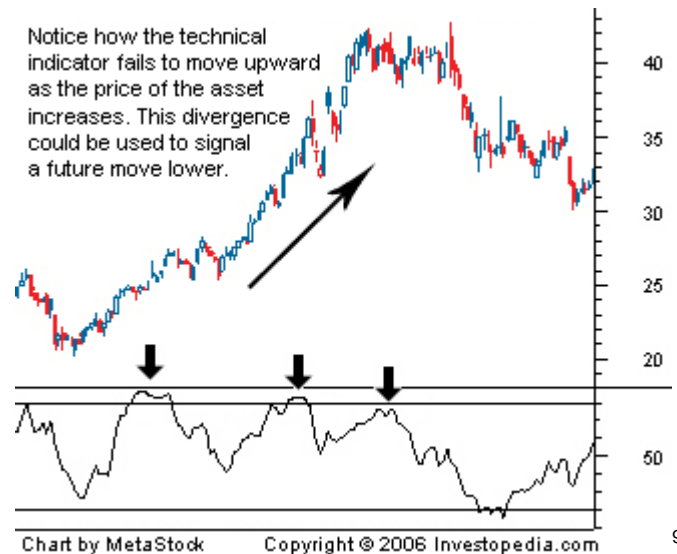
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<sup>7</sup> <http://www.investopedia.com/terms/o/overbought.asp>

<sup>8</sup> <http://www.investopedia.com/terms/o/oversold.asp>



this means that the current trend is coming to an end. The trend is losing strength and its momentum is weakening. Traders should expect either a full trend reversal or a consolidation in volatility. The following figure shows an example of where the indicator diverges from the price trend; shortly thereafter the trend slows and reverses.



*Figure 2.3: indicator and price chart divergence*

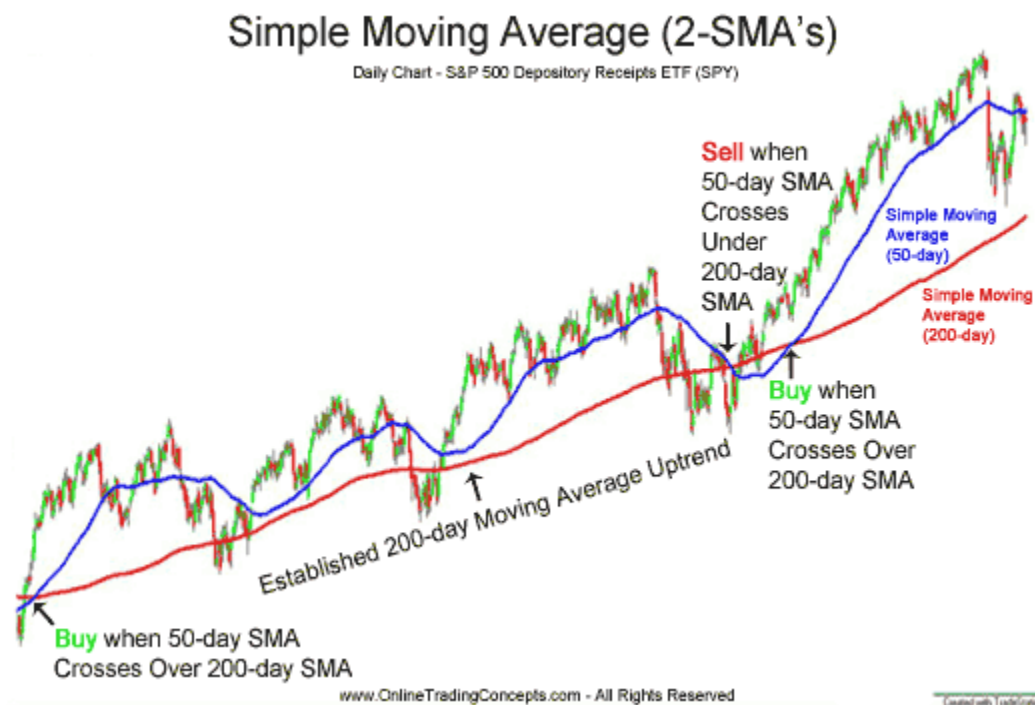
Another chart pattern that occurs is called crossover. There are two types of crossover to look for: centerline crossover signals and moving average crossovers. Centerline crossovers occur on oscillators that fluctuate above and below a centerline. A centerline crossover is interpreted as a buy or sell signal. A buy signal would be generated with a cross above the centerline and a sell signal with a cross below the centerline. For MACD or ROC, a crossover above or below zero would result in the same signal.

The other type of crossover to look for is the moving average crossover. A moving average crossover occurs when a faster moving average (i.e. a shorter period Moving Average) crosses

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<sup>9</sup> <http://www.investopedia.com/terms/d/divergence.asp>

either above a slower Moving Average (i.e. a longer period Moving Average) which is considered a bullish crossover or below which is considered a bearish crossover.<sup>10</sup> Moving average crossover is more of a long term strategy and traders should wait for the price chart trend to verify the indicator. Below is an example of moving average crossover:



*Figure 2.4: moving average crossover*

## 2.8 Momentum Indicators

Momentum indicators, often known as oscillator indicators, measure the rate of change of a price movement. Momentum indicators are used to detect trend weakness and locations of where a trend reversal might occur. This means a trader should buy when the indicator

<sup>10</sup> <http://www.onlinetradingconcepts.com/TechnicalAnalysis/MASimple2.html>

bottoms and turns back up and sell when the indicator peaks and turns down. Momentum is calculated by calculating the current price compared to the price over a past period of time. To generalize, a momentum indicator is used to detect the enthusiasm of the buyers or sellers at the current point in time. When a market peaks the indicator will climb steeply to match the market movement and then drop off sharply when the market trend loses strength. When a momentum indicator is showing a trend reversal, it is important to wait for the price chart to also match the reversal. It does not make sense to enter into a position when a momentum indicator and a price chart are not showing corresponding patterns because it is not uncommon for momentum indicators to diverge from the price chart.<sup>11</sup> It's critical to see the price reverse when the indicator also reverses.

The following figure shows places where the momentum indicator is showing a trend reversal and the price chart is also matching that trend reversal.



<sup>11</sup> [http://www.trade10.com/momentum\\_indicators.htm](http://www.trade10.com/momentum_indicators.htm)

*Figure 2.5: Momentum indicator showing signs of trend reversal*

There are several weaknesses that are associated with momentum indicators. Every market has a high and a low over a period of time, and this indicator displays the amount of buyers and sellers and the volume to make it easy to see when the market has hit a peak and will turn back. These peaks are achieved when the amount of people buying slows down and the price slowly increases. As for other indicators, it does not predict the direction of the market. It shows the likelihood of the market changing. Additionally, in a ranging market price movement tend to erratic and may not have a strong driving force behind them. Finally, as a result of the method a momentum indicator is derived, abnormally high or low price ranges in the window that is being compared can cause distortion in the information the indicator is showing.<sup>12</sup> For example, if a momentum indicator is comparing the current price to the price in the past 15 bars and an abnormally high peak in price in the past 15 bars occurs, there will be a distortion in information that the momentum indicator is currently displaying because of the abnormal price peak.<sup>13</sup> Certain momentum indicators correct for these weakness better than others.

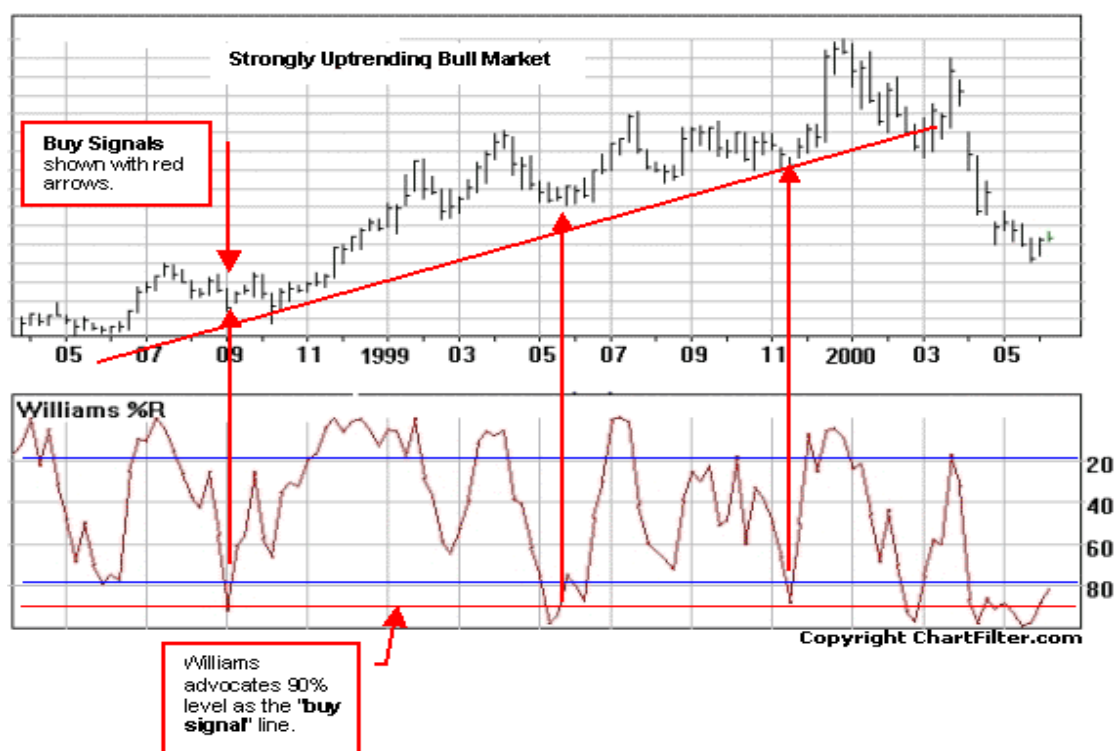
Oscillating indicators are high and low barriers on an infinite number of prices that a currency could reach. This gives the investor a smaller range of possible change in a price by identifying high and low turning points over a certain period of time. However, a high can easily be superseded at any given moment, since the indicator is only based on passed data and the market is ever-changing. From the wide variety of momentum indicators, some are

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<sup>12</sup> [http://www.incrediblecharts.com/indicators/momentum\\_indicators.php#go-Momentum-Indicators-toc1](http://www.incrediblecharts.com/indicators/momentum_indicators.php#go-Momentum-Indicators-toc1)

<sup>13</sup> [http://www.incrediblecharts.com/indicators/momentum\\_indicators.php#go-Momentum-Indicators-toc1](http://www.incrediblecharts.com/indicators/momentum_indicators.php#go-Momentum-Indicators-toc1)

used differently than others and some tend to be easier to understand graphically. For example, a Williams oscillator will reflect every change in current market prices, while an RSI has an easier user interface and can give simple graphical output. Below is an example of an oscillator; it shows which percentage of the range when one should buy or sell: if it goes above 90% (downwards), one would buy.<sup>14</sup>



*Figure 2.6: example of a Williams oscillator*

Momentum indicators are connected to trend indicators because these indicators show the strength of the force behind the trend. A person can use a momentum indicator to see if a trend has the strength to continue or if it is weakening and will soon slow and reverse.

<sup>14</sup> <http://www.fxwords.com/w/williams-r.html>

Momentum indicators can be used to describe trends in markets over a certain period of time, which can be broken down and made into smaller trends. Oscillators can also be combined to form better tools for trading according to the investor.

There are certain indicators that hint that there would be a reversal in the current trend. Recognizing when a trend is going to reverse is important because it can alert you when to enter a trade or when to close your current position. Several important indicators to look for are the CCI Indicator, MACD, the spinning top, and railroad tracks. If several of these indicators are showing at the same time, the probability for a change in trend is increased. Although there is no perfect indicator, these three indicators are an accurate way to catch a trend reversal before it happens.

### 2.8.1 ROC Indicator

The Rate of Change indicator or ROC is a simple momentum indicator that measures the percent change in price over a period of time. The indicator oscillates above and below a zero line which represents 0% change from the previous price. "Just like a typical a momentum oscillator, ROC signals include centerline crossovers, divergences and overbought-oversold readings."<sup>15</sup> If the rate of change remains positive the price will rise and if the rate of change decreases the price will fall. "The ROC measures changes in prices amount during the certain time and represents it as an oscillator showing the cyclical movement. The ROC increases along with the prices up trending and it decreases when the prices go down."<sup>16</sup> Figure ## shows a Rate of change indicator oscillating between -20% and 10%

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<sup>15</sup> [http://stockcharts.com/help/doku.php?id=chart\\_school:technical\\_indicators:rate\\_of\\_change\\_roc\\_a](http://stockcharts.com/help/doku.php?id=chart_school:technical_indicators:rate_of_change_roc_a)

<sup>16</sup> <http://www.forexrealm.com/technical-analysis/technical-indicators/rate-of-change.html>



*Figure 2.7: example of the Rate of Change indicator*

### 2.8.2 RSI Indicator

The Relative Strength Index (RSI) is a momentum oscillator developed by J. Welles Wilder, that measures the speed and change of price movements. RSI oscillates between zero and 100. A commodity is considered overbought when the RSI exceeds 70 and oversold when it reaches below 30. The main function of this indicator is to determine if a commodity is overbought or oversold. It does this by comparing the magnitude of recent gains to the magnitude of recent losses.<sup>17</sup> However, it should be known that large surges or steep drops in the prices will cause the RSI to produce false buy or sell indicators. It is recommended to use this indicator together with another indicator in order to reinforce its signal and to ensure that it is not sending a false signal because of this flaw.

<sup>17</sup> <http://www.investopedia.com/terms/r/rsi.asp>



*Figure 2.8: example of the RSI indicator*

### 2.8.3 Stochastic Indicator

Stochastic indicators are momentum indicator designed by George C. Lane. They are not designed to follow volume or price movement, but rather it follows the speed or momentum that a price is moving in. The Stochastic indicator can predict reversals and also overbought and oversold conditions. "The main idea behind Stochastic indicator according to its developer, George Lane, lies in the fact that rising price tends to close near its previous highs, and falling price tends to close near its previous lows."<sup>18</sup> The stochastic indicator consists of two lines, a fast line and a slow line. The indicator oscillates between 0 and 100 and also consists of lines at 80 and 20 to indicate overbought and oversold positions. Many traders watch both the fast and slow stochastic lines for crossovers. For example, if the fast line from above crosses the slow line downwards traders open Sell orders. Conversely, when the fast

<sup>18</sup> <http://forex-indicators.net/stochastic>



line from below crosses slow line upwards traders open Buy orders. This is the same strategy used with moving averages. If these crossovers occur above the 80% level and below the 20% the signal is considered to be even stronger. The lines can remain in the overbought or oversold zones for a while in a trending market so it is important to wait for the lines to leave the zone in order to confirm the trend is reversing.

There are three types of stochastic, full, fast and slow. In the fast stochastic the %K Line, or the fast line, is not smooth and it not plotted as a moving average. In the slow stochastic the %K line is smoothed by using a 3 period moving average of the %K line. Basically, the %K line will move more in the fast stochastic. The fast stochastic will allow you to enter into trades earlier because it will give earlier signals than the slow stochastic. The fast stochastic allows you to get into trades earlier, but can also cause you to enter into false positions because it will be moving more inaccurately than the slow stochastic. With the full stochastic you can also choose a simple moving average for the %K line like in the slow stochastic, but what makes it unique is you can also change the number of periods which smoothes out the %D line, or slow line.

Below is an example of a slow stochastic indicator. It has levels at 80% and 20% in order to determine overbought and oversold locations. The %K or fast line is in red and % D or slow line is in blue.



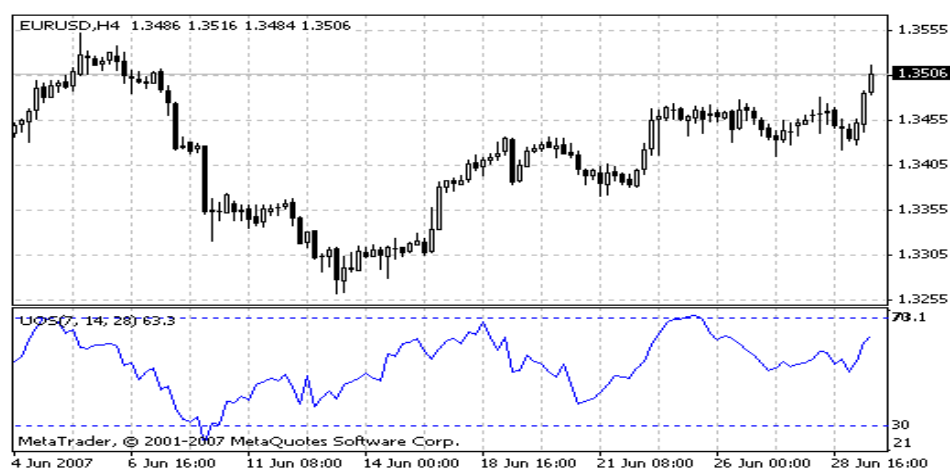
*Figure 2.9: example of the slow stochastic indicator*

#### 2.8.4 Ultimate Oscillator Indicator

The Ultimate Oscillator is a momentum oscillator designed to capture momentum across three different timeframes. It was designed by Larry Williams and it incorporates larger time frames to try and improve some of the flaws that are evident with traditional oscillators. “Many momentum oscillators surge at the beginning of a strong advance and then form bearish divergence as the advance continues. This is because they are stuck with one time frame. The Ultimate Oscillator attempts to correct this fault by incorporating longer timeframes into the basic formula.”<sup>19</sup> Using three time periods reduces the volatility and

<sup>19</sup> [http://stockcharts.com/help/doku.php?id=chart\\_school:technical\\_indicators:ultimate\\_oscillator](http://stockcharts.com/help/doku.php?id=chart_school:technical_indicators:ultimate_oscillator)

decreases the chances of false signals that maybe result when just a single time period is used.<sup>20</sup> The ultimate oscillator fluctuates between 0 and 100. Overbought, oversold and divergence are the type of signals that traders look for in the ultimate oscillator. The ultimate oscillator tries to predict buying pressure. When Buying Pressure is strong the ultimate oscillator rises and falls when buying pressure is weak. The centerline acts as a bear/bull divider line. So if the ultimate oscillator moves above the center line the market is a bull and the buying pressure is strong. If it moves below the center line the market is considered to be a bear and the buying pressure is weak.



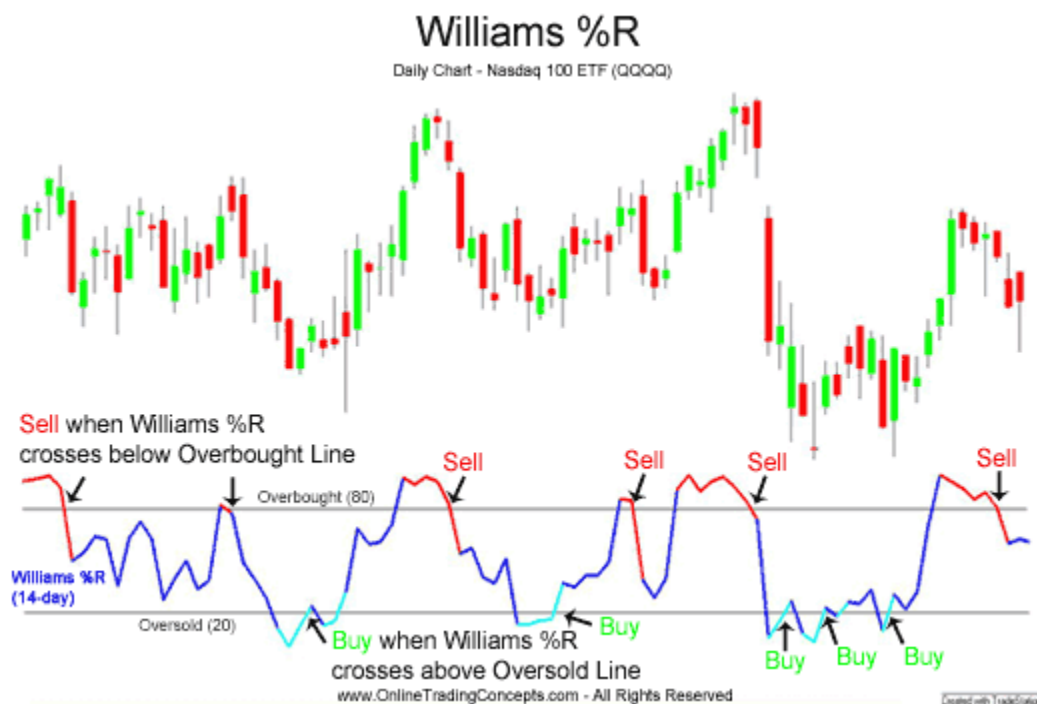
*Figure 2.10: example of the Ultimate Oscillator*

### 2.8.5 Williams % R Indicator

The Williams % R is a momentum indicator, developed by Larry Williams, that is the exact opposite of the fast stochastic. “Williams %R reflects the level of the close relative to the highest high for the look-back period. In contrast, the Stochastic Oscillator reflects the level of

<sup>20</sup> <http://www.investopedia.com/terms/u/ultimateoscillator.asp>

the close relative to the lowest low. %R corrects for the inversion by multiplying the raw value by -100.<sup>21</sup> The Williams % R looks exactly like the fast stochastic and gives the same signals. Just like the fast stochastic the Williams %R does a great job of identifying overbought and oversold markets.



*Figure 2.11: example of a Williams % R indicator*

### 2.8.6 Awesome Oscillator

The Awesome Oscillator is used to help predict price movements of a given pair, like any other indicator. It is calculated by finding the difference between the 5 period moving average and the 34 day moving average across the central points of the bars.

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<sup>21</sup> [http://stockcharts.com/school/doku.php?id=chart\\_school:technical\\_indicators:williams\\_r](http://stockcharts.com/school/doku.php?id=chart_school:technical_indicators:williams_r)

Each day is either a line up or a line down these days are called bars. When the bars are trending down and then start moving up it is a buy signal. When the bars are trending up but then start moving down it is considered a sell signal.<sup>22</sup>



*Figure 2.12: example of awesome oscillator indicator*

## 2.9 Trend Indicators

Trend indicators are designed to detect the direction of price movement. A trend can be going in three directions: buy, sell, and neutral. A good practice is to only enter into a position that is in the same direction as the prevailing trend so if there is a buy trend it would be risky and unwise to enter into a sell position. Trend indicators eliminate some of the noise that is associated with a bar chart to try and give a smooth reflection of price movement. The problem with this is sometimes the indicators can lag as they react to the candlestick bars. As a

<sup>22</sup> [http://2.bp.blogspot.com/\\_-HDIQj7--o8/SS2rg3dfjrl/AAAAAAAAAX4/SwMgocINhyM/s400/awesome+oscillator.gif](http://2.bp.blogspot.com/_-HDIQj7--o8/SS2rg3dfjrl/AAAAAAAAAX4/SwMgocINhyM/s400/awesome+oscillator.gif)

result of this lag trend indicators are misleading in a ranging or oscillating market. It's important to only rely on a trend indicator when the market is in a strong trend and not in an oscillation pattern. In a ranging market the price fluctuates too fast for a trend indicator and sometimes can give false information to traders.<sup>23</sup>

Trend indicators are effective because the price movement reflects the major economic data that is prevalent at the present time. If a person follows the economic news releases and then watches the trend indicator on a chart they can find good locations to enter into a trend.<sup>24</sup> It's important to let a trend establish for a bit in order to ensure that the strength of the price movement is strong. By using this strategy you won't catch the entire trend, but your risks of entering into a bad position is decreased. Although this is a conservative trading method it is still effective. Any time your risk is reduced typically the amount of profit is also reduced, although this isn't necessarily a bad thing because it is critical to manage your losses and try and minimize the number of bad positions you enter into. Moving averages are indicators that measure the momentum and direction of a trend. The idea behind moving averages is that the price of a currency pair or stock will fluctuate above and below the average over a period of time. Momentum is calculated by determining if the current prices are above or below the market's average value. The period of time of an average is picked at random because it is impossible to calculate the average (the market opened in 1980 and is relevant to current time investing.) There are many types of moving averages; they include simple moving averages, exponential moving averages, smoothed moving averages, and linear regressed moving

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<sup>23</sup> [http://www.incrediblecharts.com/indicators/trend\\_indicators.php](http://www.incrediblecharts.com/indicators/trend_indicators.php)

<sup>24</sup> <http://www.forextraders.com/forex-analysis/forex-technical-analysis/forex-trend-indicators.html>

averages. A simple moving average is the easiest to understand, as all the data is collected by averaging the closing prices over a certain amount of time and no weighting is used.<sup>25</sup>



*Figure 2.13: example of a simple moving average indicator:*

An exponential moving average highlights the numbers from other moving averages to give a better understanding to most recent prices. When finding the exponential moving average, it is done by exponentially decreasing the movement towards past values on the left of the graph; giving greater value to most recent prices and allowing a more up-to-date moving average with recent prices.

A smoothed moving average is very similar to an exponential moving average. The only difference is that all the prices over the history of the market are taken into account. The exponential characteristic still applies, but it goes further back into history, not just over a set

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<sup>25</sup> <http://www.investopedia.com/articles/technical/052201.asp>

period of time. This indicator is also used more commonly for, as described by the name, smoothing price fluctuation by removing short-term volatility. It is useful to show clearly the long term momentum of the market.

Linear regressed moving averages are similar to both simple moving averages and exponential moving averages. However, instead of weighting past data that is exponentially less, it does so linearly. It starts with an initial given period of time (n) that is multiplied by 1. A more recent consecutive period of time is chosen and (n-1) and is multiplied by a factor of 2, and so on until present time is reached. The following indicators are examples of trend indicators.

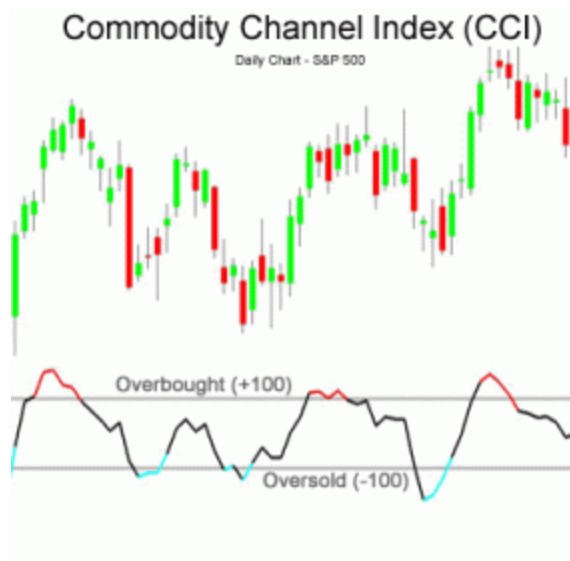
#### 2.9.1 CCI indicator

The first indicator to use to try and spot a trend reversal is the CCI indicator. "An oscillator used in technical analysis to help determine when an investment vehicle has been overbought and oversold."<sup>26</sup> It is calculated by subtracting the forex price minus the Moving Average, which is then divided by the standard deviation. The CCI, which was designed by Donald Lambert is used to identify cyclical trends. When the indicator generates a signal outside of the range of -100 to +100 a buy or sell signal is apparent. For example, When the CCI crosses below the -100 level there is a strong downtrend and a sell signal is appropriate. The CCI also gives realistic evidence to approximate changes in the direction of price movement. For example, when the indicator hits a certain mark like +200 investors usually wait for the indicator to retreat back to +100 before entering into a position in the direction of the now strong downtrend.

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<sup>26</sup> <http://www.investopedia.com/terms/c/commoditychannelindex.asp>





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*Figure 2.14: example of the CCI indicator*

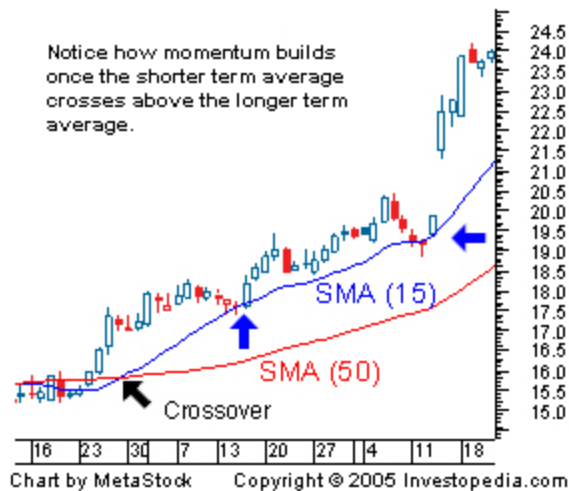
### 2.9.2 Simple Moving Average

The simple moving average is calculated by adding the closing price of the security for a number of time periods and then dividing this total by the number of time periods. In other words, this is the average currency pair price over a certain period of time.<sup>28</sup> Equal weighting is given to each daily price. The trader should watch for short-term averages to cross above longer-term averages to signal the beginning of an uptrend. Short-term averages often act as levels of support when the price experiences a drop. Support levels become stronger and more significant as the number of time periods used in the calculations increases.

Below is an example of the short term moving average indicator:

<sup>27</sup> <http://forextradingstrategiessystems.com/tag/relative-strength-index/>

<sup>28</sup> <http://www.investopedia.com/terms/s/sma.asp>



**Figure 2.15: example of the simple moving average indicator**

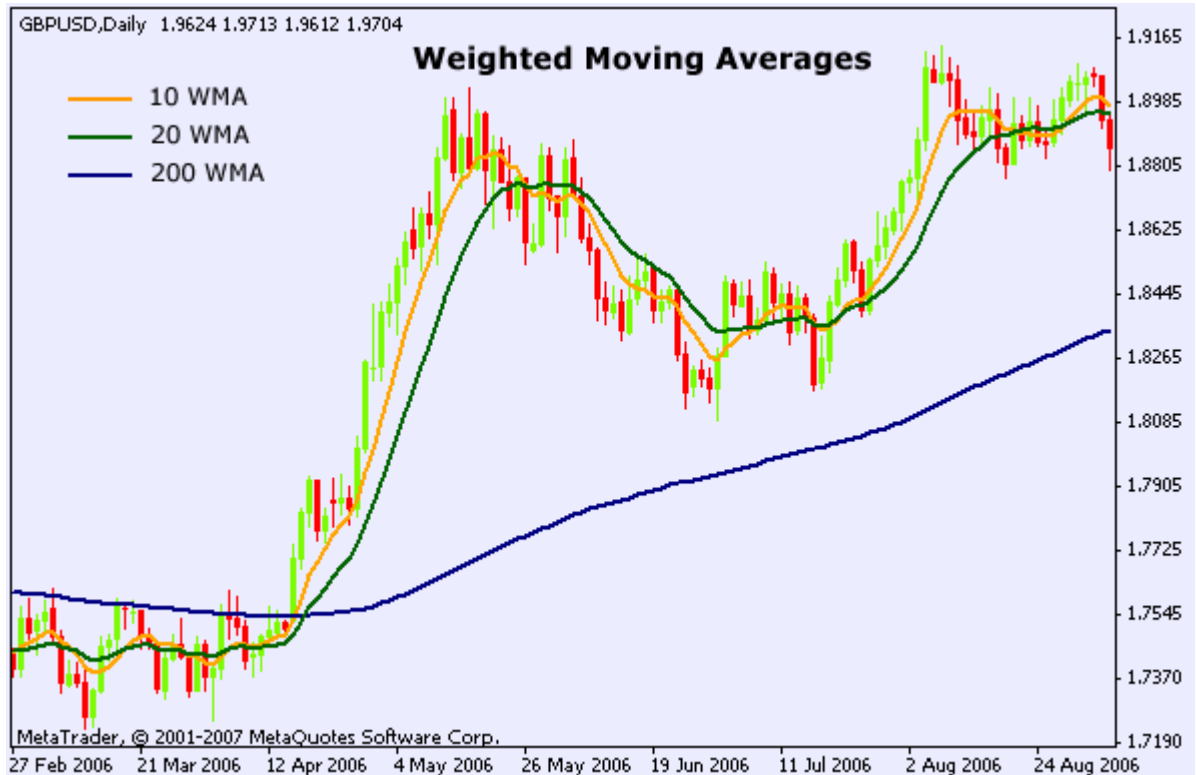
In the figure above take notice of the smaller amount of days taken consideration the closer the moving average resembles the actual price of the pair.<sup>29</sup> For an investor it is better to take into consideration all of the moving averages in order to have a better comprehension of the trends of the currency pair through the allotted time.

### 2.9.3 Weighted Moving Average

The WMA is calculated like an SMA except that more weighting is given to the more recent prices. The theory is that the older the price the less relevance it should have on the moving average. This average is calculated by taking each of the closing prices over a given time period and multiplying them by its certain position in the data series. Once the position of the time periods have been accounted for they are summed together and divided by the sum of the number of time periods. For example, in a 15-day linearly-weighted moving average, today's closing price is multiplied by 15, yesterday's by 14, and so on until day 1 in the period's

<sup>29</sup>[http://stockcharts.com/school/data/media/chart\\_school/technical\\_indicators\\_and\\_overlays/moving\\_averages/mova-2-spylag.png](http://stockcharts.com/school/data/media/chart_school/technical_indicators_and_overlays/moving_averages/mova-2-spylag.png)

range is reached. These results are then added together and divided by the sum of the multipliers ( $15 + 14 + 13 + \dots + 3 + 2 + 1 = 120$ ).<sup>30</sup> The linearly weighted moving average was one of the simplest of the weighted moving averages and the popularity of this moving average has been diminished by the exponential moving average, but is still very useful.



*Figure 2.16: example of the weighted moving average indicator*

Once again looking at moving averages, it is always best to look at the shortest moving averages for immediate trend, but looking at moving averages that go farther back is also very useful. The weighted moving average takes into account many factors when it is calculated and gives more weight to recent events in the trend of the currency pair making it a one stop tool for an investor.

<sup>30</sup> <http://www.investopedia.com/terms/l/linearlyweightedmovingaverage.asp>

### 2.9.4 Exponential Moving Average

This type of moving average reacts faster to recent price changes than a simple moving average. The 12- and 26-day EMAs are the most popular short-term averages, and they are used to create indicators like the moving average convergence divergence and the percentage price oscillator. In general, the 50 and 200 day EMAs are used as signals of long-term trends.<sup>31</sup>



Figure 2.17: example of the exponential moving average indicator

The figure above shows the relationship between the simple moving average and the exponential moving average where the exponential moving average relates more to the actual price of

<sup>31</sup> <http://www.babypips.com/school/images/grade4/exponential-moving-averages2.png>

the currency pair because it weighs the older prices less than those recent prices<sup>32</sup>. This gives the investor a more accurate representation of the current price.

### 2.9.5 MACD indicator

The Moving Average Convergence-Divergence indicator or the MACD, is a momentum indicator developed by Gerald Appel. It is an important indicator to help identify who is driving the price movement, either the buyers or the sellers. MACD subtracts the longer moving average from the short moving average to form a momentum oscillator. "As a result, MACD offers the best of both worlds: trend following and momentum."<sup>33</sup> MACD fluctuates above and below the zero line as the moving averages converge, cross and diverge. Traders can look for signal line crossovers, centerline crossovers and divergences to generate signals. "When you are in an upward movement and you see the MACD histogram shortening, it is a sign that the buyers are losing strength and a possible reversal is coming."<sup>34</sup> If you are in a downward movement and you see the bars of the histogram shortening, it is sign that the sellers are losing strength while the buyers are gaining strength. It is not particularly useful for identifying overbought and oversold levels because it is unbounded.

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<sup>32</sup> [http://www.aboutcurrency.com/images/university/fxtechnicalindicators/simple\\_moving\\_averages.gif](http://www.aboutcurrency.com/images/university/fxtechnicalindicators/simple_moving_averages.gif)

<sup>33</sup> [http://stockcharts.com/school/doku.php?id=chart\\_school:technical\\_indicators:moving\\_average\\_conve](http://stockcharts.com/school/doku.php?id=chart_school:technical_indicators:moving_average_conve)

<sup>34</sup> <http://www.forexindicator.org/my-favourite-forex-reversal-indicators.html>

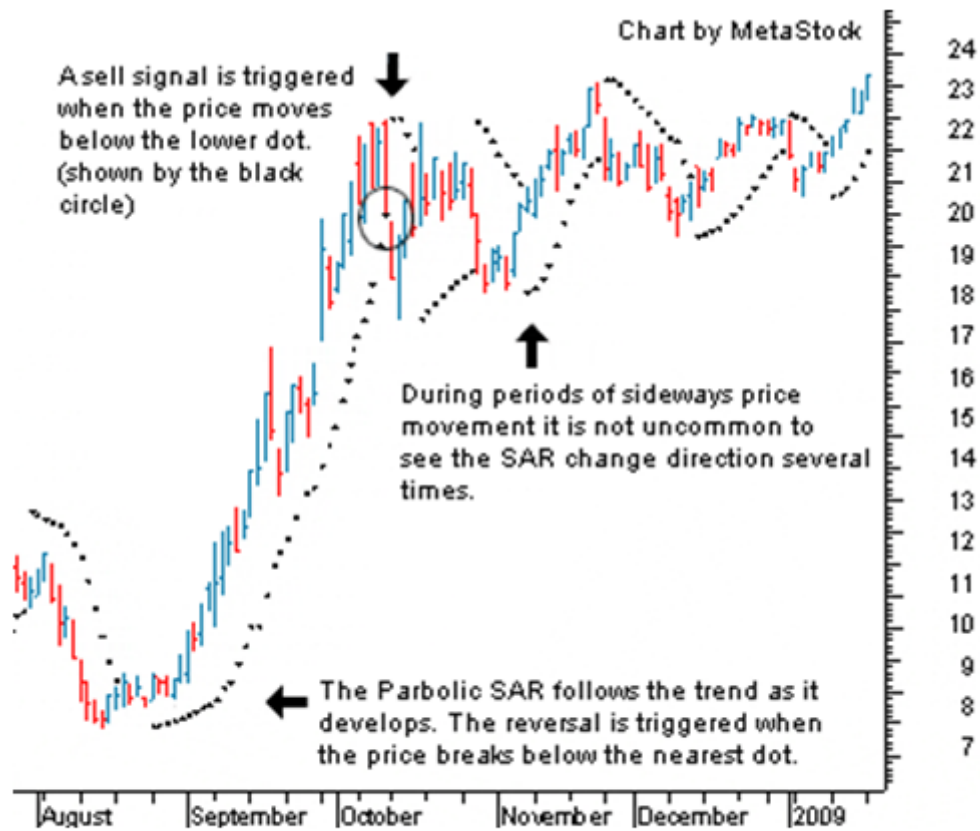


*Figure 2.18: example of the MACD indicator*

### 2.9.6 Parabolic SAR Indicator

Parabolic SAR Technical Indicator was developed for analyzing the trending markets. The indicator is below the prices on the bull market, Up Trend, when it's bearish, Down Trend, it is above the prices. The indicator is constructed on the price chart. This indicator is like the Moving Average Technical Indicator with the only difference that Parabolic SAR moves with higher acceleration and may change its position in terms of the price.

If the price crosses Parabolic SAR lines, the indicator turns, and its further values are situated on the other side of the price. When such an indicator turn does take place, the maximum or the minimum price for the previous period would serve as the starting point.



*Figure 2.19: example of a the Parabolic SAR indicator*

### 2.9.7 ADX Indicator

An indicator used in technical analysis as an objective value for the strength of trend. ADX is non-directional so it will quantify a trend's strength even if it is up or down. ADX is usually plotted in a chart window along with two lines known as the Directional Movement Indicators.



**Figure 2.20: example of the ADX indicator**

In the figure above it is possible to observe how the average directional index gives the investor the possibility of predicting the strength of the trend.<sup>35</sup> When the ADX goes above 20 it is safe to say that the trend is increasing over a period of time, and well as if the ADX falls below 40 the trend is decreasing and will reverse at some approaching moment.

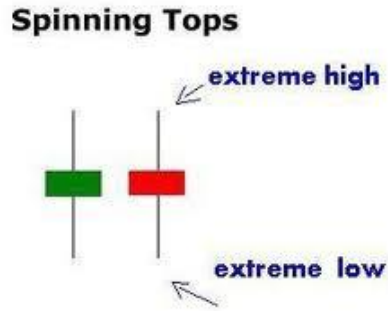
Investors use ADX to predict trend strengths along with directional movement indicators, because ADX only quantifies the trend, the directional movement indicators tell the investor if the trend is up or down. With this tool it is easier for the investor to make decisions on whether to trade or not.

### 2.9.8 Candlestick trend reversal indicators

Along with these indicators certain candle stick patterns can be signs of a trend reversal. The first is called a spinning top. This is when there is a short body and long wicks. This is an indicator that there is indecision between the sellers and buys. This indicates the end of a trend because the support that was driving the trend is now weakening.

<sup>35</sup> <http://i.investopedia.com/inv/dictionary/terms/ADX2.gif>





*Figure 2.21: example of a Spinning Top candlestick pattern.*

The final indicator that can hint that a trend reversal is looming is called the railroad tracks. That is when a long opposite candle follow each other. It shows that a high volume of people enter a position and then are quickly closing their positions and enter the opposite position.

### 2.10 Volume Indicators

These indicators show the volume of trades behind a particular price movement which can be extremely useful to a trader because a price movement backed up by high volume is a much stronger signal than when price movement based on low volume. Volume is defined as the number of shares or contracts traded during a given period of time. It is simply the amount of shares that trade hands from sellers to buyers as a measure of activity.<sup>36</sup> If a buyer of a stock purchases 200 shares from a seller, then the volume for that period increases by 200 shares. Volume indicators are very useful because if the markets have made strong price move either up or down the perceived strength of that move depends on the volume for that period. The higher the volume during that price move the more significant the move.

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<sup>36</sup> <http://www.investopedia.com/terms/v/volume.asp>

### 2.10.1 Chaikin Money Flow

The Chaikin Money flow is an example of a volume indicator designed by Marc Chaikin based on the Accumulation Distribution line. This line is designed to measure the cumulative flow of money into and out of a security. This line gauges supply and demand by determining whether investors are generally "accumulating" (buying) or "distributing" (selling) a certain stock.<sup>37</sup> The Chaikin money flow attempts to determine if a stock is under accumulation or distribution by comparing the closing price to the high-low range of the trading session. If the stock closes near the high of the session with increased volume, the Chaikin money flow increases in value. Conversely, if the stock closes near the low of the session with increased volume, the Chaikin money flow decreases in value.<sup>38</sup> Below is an example of the Chaikin money flow indicator.



<sup>37</sup> <http://www.investopedia.com/terms/a/accumulationdistribution.asp>

<sup>38</sup> <http://www.mysmp.com/technical-analysis/chaikin-money-flow.html>

*Figure 2.22: example of the Chaikin money flow indicator*

**2.10.2 Force Index**

Developed by Alexander Elder, the Force index combines price movements and volume to measure the strength of buyers and sellers in the market. It is calculated by subtracting the close from the current period from the close from the previous period, and then multiplying this by the volume. Force Index= [(Current Close)-(Previous Close)]\* Volume. Sometimes the force index is smoothed out by using a 13 period moving average. The indicator does not oscillate between a set range, but if the Force index is above zero it signals that the bulls are in control. Negative Force index signals that the bears are in control. If the index whipsaws around zero it signals that neither side has control and no strong trend exists.<sup>39</sup> There are three elements to the Force Index. First, there is either a positive or negative price change. A positive price change signals that buyers were stronger than sellers, while a negative price change signals that sellers were stronger than buyers. Second, there is the extent of the price change, which is simply the current close minus the prior close. The "extent" shows us just how far prices moved. A big advance shows strong buying pressure, while a big decline shows strong selling pressure. The third and final element is volume, which, according to Elder, measures commitment. Just how committed are the buyers and sellers? A big advance on heavy volume shows a strong commitment from buyers. Likewise, a big decline on heavy volume shows a strong commitment from sellers. The Force Index quantifies these three

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<sup>39</sup> [http://www.incrediblecharts.com/indicators/force\\_index.php](http://www.incrediblecharts.com/indicators/force_index.php)

elements into one indicator that measures buying and selling pressure.<sup>40</sup> Below is an example of the Force index indicator.



<sup>40</sup> [http://stockcharts.com/help/doku.php?id=chart\\_school:technical\\_indicators:force\\_index](http://stockcharts.com/help/doku.php?id=chart_school:technical_indicators:force_index)

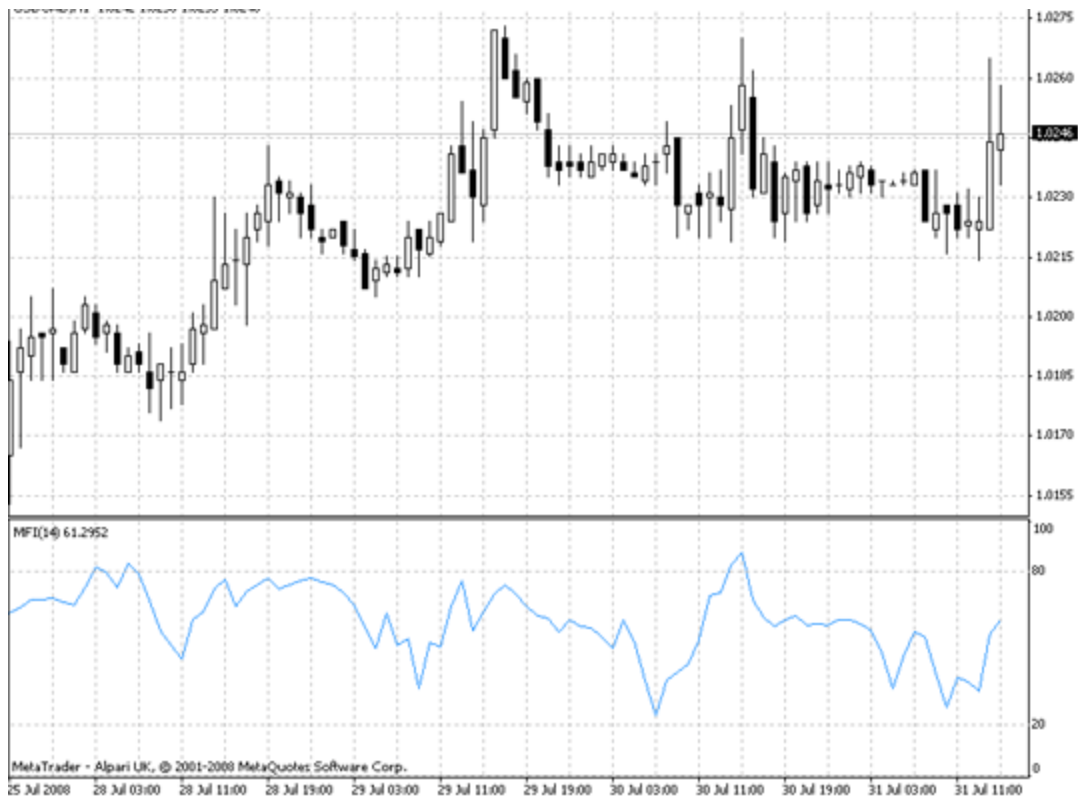
*Figure 2.23: example of a the force index indicator*

### 2.10.3 Money Flow Index

The money flow index is similar to the relative strength index (RSI). The fundamental difference is that the MFI also accounts for volume, whereas the RSI only incorporates price. The money flow index uses both price and volume to measure buying and selling pressure. Money Flow Index is an oscillator calculated over an N-day period, ranging from 0 to 100, showing money flow on up days as a percentage of the total of up and down days.<sup>41</sup> *Money Flow = typical price x volume* and *Typical price = (high + low + close) / 3*. The indicator oscillates between 0 and 100. A value of 80 is generally considered overbought, and a value of 20 oversold. Divergences between money flow index and the price chart is also considered significant. Below is an example of the Money flow index indicator:

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<sup>41</sup> <http://www.fxnonstop.com/index.php/component/content/article/35-indicators/58-money-flow>



*Figure 2.24: example of the monet flow index indicator*

#### 2.10.4 Ease of Movement

A technical momentum indicator designed by Richard W. Arms, Jr. that is used to illustrate the relationship between the rate of an asset's price change and its volume. This indicator attempts to identify the amount of volume required to move prices.<sup>42</sup> Generally a value greater than zero is an indication that the stock is being accumulated (bought) and negative values are used to signal increased selling pressure. A high positive value appears when prices move upward on low volume. Strong negative numbers indicate that price is moving downward on low volume. This indicator is useful for identifying the strength of trends.

<sup>42</sup> <http://www.onlinetradingconcepts.com/TechnicalAnalysis/EaseofMovement.html>



*Figure 2.25: example of the ease of movement indicator*

### 2.11 Volatility Indicators

Volatility Indicators show the size and magnitude of price fluctuations. Over a period of time markets will experience periods of high volatility and periods of low volatility. Measuring the intensity of the price fluctuations is crucial because it is important to know what type of market you are about to be trading in. A market that is low intensity will have low price movements, which make it difficult to generate a large profit. Low volatile markets may seem like a negative because there is not much movement in the price, but it is important to know that eventually the market will pick up intensity. Low volatile period history precede periods of high volatility. Traders look for the period of low volatility to breakout because this leads to a high intensity market and larger price fluctuations. The following are examples of some popular volatility indicators.

### 2.11.1 Chaikin Volatility

Marc Chaikin's volatility indicator calculates the spread between the maximum and minimum prices. It judges the value of volatility basing on the amplitude between the maximum and the minimum. "In general, high values of Chaikin's volatility indicator indicate increased market volatility and low values indicate low volatility. There are two basic methods to interpret Chaikin's graphs"<sup>43</sup>:

- Assume that market tops are accompanied by increased volatility and market bottoms are accompanied by decreased volatility.
- Assume that increase in indicator over a shorter time period indicates near-future market bottom and decrease in indicator over a longer period indicates near-future market top.

However, unlike the Average True Range indicator, Chaikin's indicator doesn't take gaps into account. Below is an example of the Chaikin Volatility indicator:

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<sup>43</sup> <http://blog.nobletrading.com/2010/05/chaikins-volatility-indicator.html>





*Figure 2.26: example of the Chaikin Volatility indicator*

### 2.11.2 Average True Range

The Average true indicator or ATR is a trading indicator that measures volatility designed by J. Welles Wilder. The Average True Range indicator was created in order to measure volatility from gap or limit moves. It is important to understand that ATR only indicate volatility of the price rather the direction. ATR reflects the current interest in a commodity not the direction. "Strong moves, in either direction, are often accompanied by large ranges, or large True Ranges. This is especially true at the beginning of a move. Uninspiring moves can be accompanied by relatively narrow ranges. As such, ATR can be used to validate the enthusiasm behind a move or breakout."<sup>44</sup> The Average True Range indicator is based on a value called the True Range. The true range is the largest value of the following three: A. The current high minus the current Low B. Absolute value of the current high minus the previous Close C. Absolute value of the current Low minus the previous Close. Large or

<sup>44</sup> [http://stockcharts.com/help/doku.php?id=chart\\_school:technical\\_indicators:average\\_true\\_range\\_a](http://stockcharts.com/help/doku.php?id=chart_school:technical_indicators:average_true_range_a)

increasing True Ranges suggest traders prepared to continue the high volatility, while decreasing range suggests waning interest. ATR values are not comparable because lower priced commodities will have a smaller true range than higher price commodities. The ATR is simply the average of the past 14 true ranges.

The following chart shows an ATR chart indicator with an area of low volatility highlighted by a yellow circle following by an increase in volatility. The volatility peaks and there is trend reversal highlighted by the blue circle. The ATR indicator by itself does not show the direction of the trend reversal but when paired up with the price chart the direction change is easily seen.



*Figure 2.27: example of the Average True Range indicator*

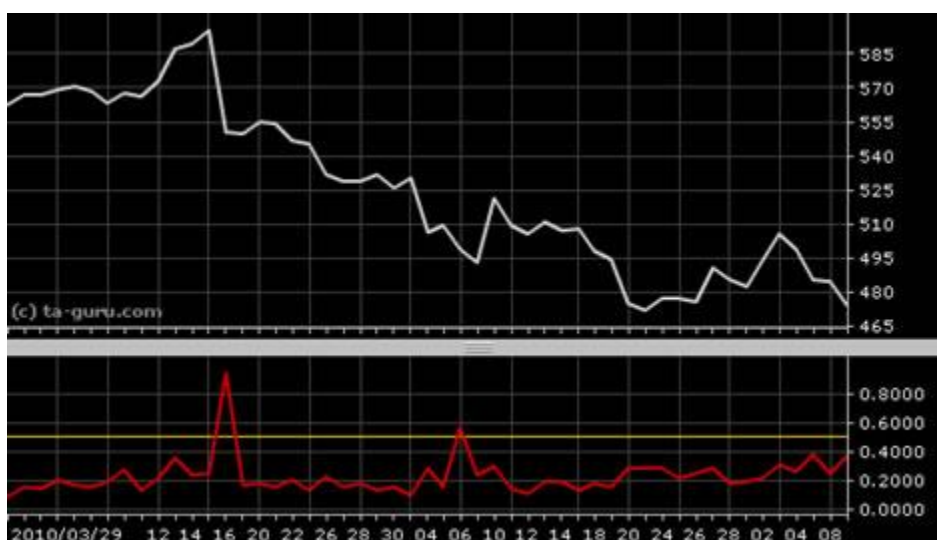
### 2.11.3 Volatility Ratio

The Volatility Ratio indicator is used to help identify breakouts by identifying when the price chart moves outside of the true range. The exact value at which a breakout trend is identified varies, but a popular level is at .5 At this level the current true range is twice the

recent true range.<sup>45</sup> It is recommended that the Volatility Ratio be combined with other indicators, such as a volume indicator, that would confirm that the current volume is supporting the breakout.

$$\text{Volatility Ratio} = \frac{\text{True Range}}{\text{True Range for last N periods}}$$

Below is an example of the volatility ratio indicator:



*Figure 2.28: example of the Volatility ratio indicator*

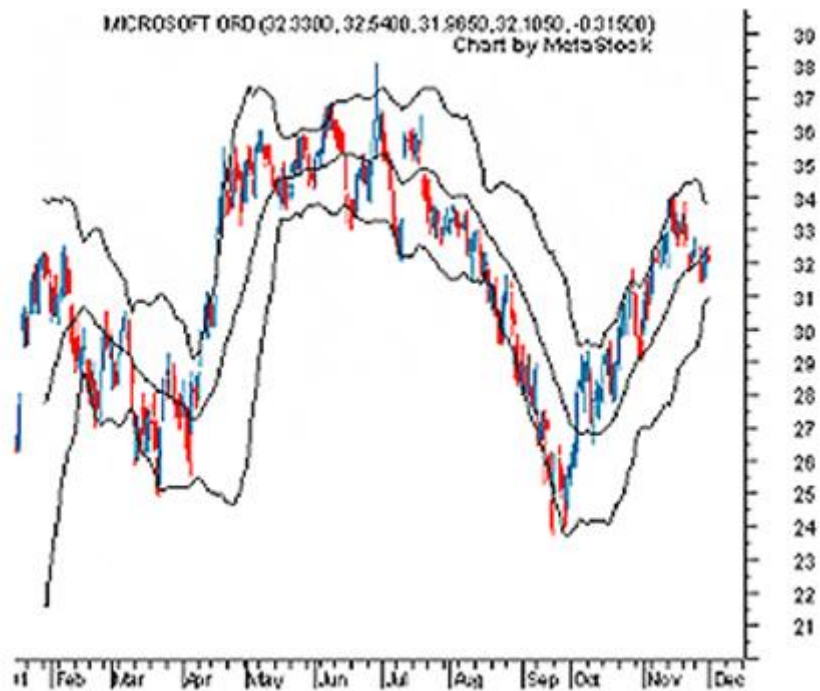
### 2.11.3 Bollinger Bands

Bollinger bands adjust themselves to the market conditions because standard deviation is a measure of volatility. When the markets become more volatile, the bands widen, they move further away from the average, and during less volatile periods, the bands contract, they move closer to the

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<sup>45</sup> <http://www.ta-guru.com/Book/TechnicalAnalysis/TechnicalIndicators/VolatilityRatio.php5>

average. The volatility is about to increase sharply when the bands tighten, so traders often use this indicator to see that.<sup>46</sup>



*Figure 2.29: example of the Bolinger Band indicator*

As can be seen in the image, the bands on the outside of the trend line touch the price at points where the volume and direction match the trend. This shows that this indicator can predict the trends of the market using the standard deviation.

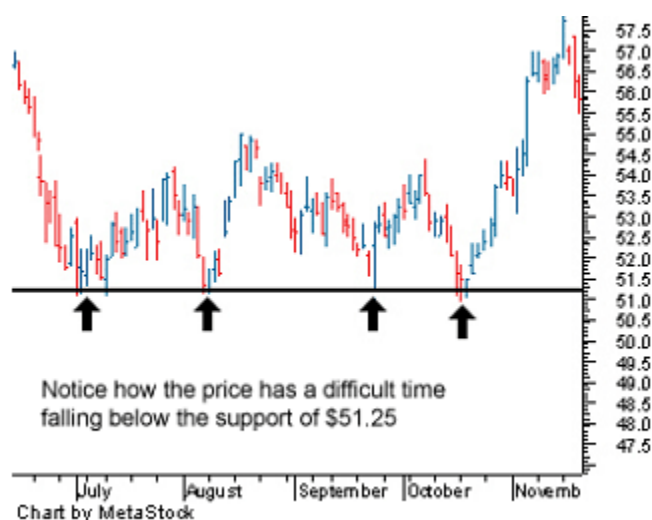
### 2.12 Price Chart patterns

When trading with a candlestick chart there are several important patterns that traders must be able to identify. When these patterns are present they can indicate upcoming trends

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<sup>46</sup> <http://i.investopedia.com/inv/articles/site/BollingerBand2.gif>

and can cause a trade to generate a market order. The first pattern to recognize is levels of support and resistance. A level of support is a level at which a price has difficult moving below because many traders enter into a buy position. A level of support is a level at which a price has difficult moving above because many traders sell at this level. Many times a price chart will hit a level of support or resistance and bounce back. If a trader can identify these levels they can profit from the bounce back. Traders must be careful because eventually the trend will have enough momentum to break through the level of support or resistance. To ensure this does not occur traders usually wait for the price chart pattern to bounce and change directions before making a market order. If the chart does break through the level of support or resistance this is a strong indicator that the trend has a lot of momentum and strength and it is safe to enter into a position that is in the same direction as the trend. The following figure shows a price chart bouncing off a level of support four different times.<sup>47</sup>



*Figure 2.30: level of support*

<sup>47</sup> <http://www.investopedia.com/terms/s/support.asp>

Another important pattern to look for is called a cross over. This occurs when the candlesticks crosses over the moving average indicator or other trend indicator. The intersection of the price chart and an indicator usually signals a buy or a sell. When the price chart crosses above the indicator, this signals a buy and when it drops below the indicator this signals a sell. Bollinger bands and moving averages are the most commonly used indicators that produce a crossover signal. Crossing over only works reliably in a trending market and can actually produce false signals in a ranging or trendless market. The follow chart illustrates examples of the price chart crossing over the moving average indicator<sup>48</sup>



*Figure 2.31: Price chart and Moving average crossover*

<sup>48</sup> <http://www.informedtrades.com/3779-learn-trade-using-moving-averages-part-2-a.html>

### 2.12.1 Fibonacci Retracement

Fibonacci Retracements are used to define areas of support and resistance. Fibonacci retracements use vertical lines on a chart to show areas of support or resistant at key levels in a span. Often times a trend will hit one of the key levels and will reverse to the original trend. Key levels are located at 23.6%, 38.2%, 50%, 61.8% and 100% of the length of the span. The key to defining accurate levels is finding a two extreme points to stretch the span across from low end to high end. Fibonacci lines can be used as locations to place orders or stop losses. Below is an example of a trend with Fibonacci lines you can clearly see both resistance levels and support at the key Fibonacci locations. <sup>49</sup>

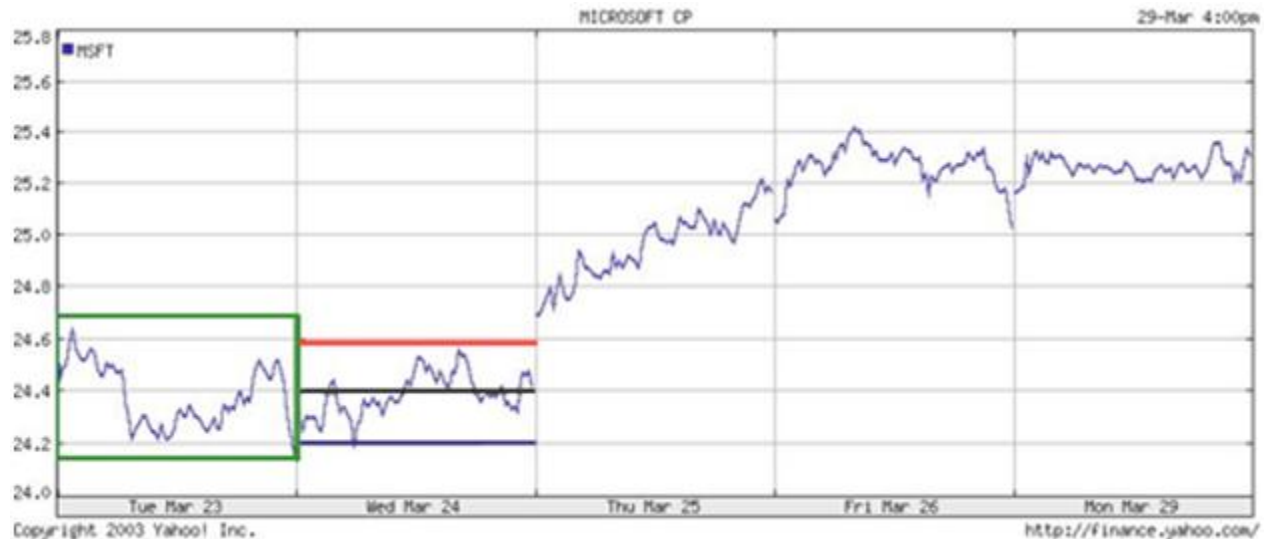


*Figure 2.32: Fibonacci Retracement lines*

<sup>49</sup> <http://www.investopedia.com/terms/f/fibonacciretracement.asp>

### 2.12.2 Pivot point indicator

The pivot point is used as an analytical indicator. If the following day's market price falls below the pivot point, it may be used as a new resistance level. In the same way that if the market price rises above the pivot point, it may act as the new support level.<sup>50</sup>



*Figure 2.33: Pivot point indicator*

Referring to the figure above, in the highlighted section it is shown how pivot point's work. They work similarly to a maximum and minimum price, where the indicator shows a buy or sell signal when the price approaches the top price or lower price.

### 2.8 Fundamental Analysis:

When trading on the foreign exchange market there are two basic forms of analysis that are used to evaluate the source of a currency's movement: fundamental analysis and technical. Fundamental analysis is a type of market analysis which entails the studying the economic condition of countries in order to trade currencies more efficiently and effectively.

<sup>50</sup> [http://i.investopedia.com/inv/articles/site/techanalysis/041404\\_1.gif](http://i.investopedia.com/inv/articles/site/techanalysis/041404_1.gif)



By obtaining economic information from political speeches, economic reports and economic legislation, traders can get an idea of a country's overall economic health and performance.

Economic reports are released by a country at scheduled times during the year. These reports detail the health of a country's economy and provide traders a clue of whether a nation's economy has improved or declined since the previously issued report. Some reports are more important than others and will cause large movements upon their announcement. The reports can detail economic topics such as unemployment, housing data, consumer sentiment, or industry strength.

The Gross Domestic Product (GDP) is report that represents the total market value of all the goods and services produces in country for a given year. It is a broad measure of the strength of a country's economy and is a measure of its internal growth. Two preliminary reports are issued before the final GDP report so if the information in all three reports is closely correlated, the volatility will be low. However, if one report is significantly different than the others it can cause significant price movement and a high volume of trades.

Another report that is worth paying attention to is Retail Sales report. This report records the total receipts of all retail stores in a given country. This measurement is derived from a diverse sample of retail stores throughout a nation. The report is adjusted for seasonal variables and is very useful because it is a great indicator of the current consumer spending sentiment. It can be used to assess the immediate strength of an economy. Once again revisions to advanced reports of retail sales can cause significant volatility and price movements.

The Industrial Production report shows the change in the production of factories, mines and utilities within a nation. It also reports their capacity utilization, which is a measure of the degree to which the capacity of which a nation's factories are being used. An ideal report for a nation will show an increase of production as well as showing the factories being near maximum capacity utilization.

The market is not always interested in every single report and some can be looked over. For example, a few years ago during the real estate boom the market largely ignored most of the housing reports because the housing market was strong at the time and the reports were consistently reflecting this information. The market assumed that the data would not change and ignored the reports. However, after the housing market crashed, reports such as U.S. Housing Start, Existing Home Sales, and New Home Sales have suddenly become more important because they can indicate that the economy is rebounding from the weak position that economy is currently stuck in.

Every economic news release has an estimated figure that is released before the actual report is released. The estimated figure is derived by surveying a sample of economists and averaging out their expected figures. Sometimes a large movement in pips can be triggered if the actual report deviates greatly from the predicted figure because the market is surprised and will react to the deviation. Typically the larger the deviation the larger the market's reaction will be. When the actual figure is released at a high deviation to the predicted figure we do not have to enter the market as soon as the figure is announced. Rather, if you wait for

the market to react you can catch the middle to end of the trend. A trader can lose a lot of money trying to get the top and bottom of the trend, but focusing on catching the middle of the trend is much safer and can still result in a respectable profit.

Following a country's interest rate is extremely important because national banks use a country's interest rate to control inflation. If a nation's currency is inflated the national bank will increase the interest rate to try and slow down the economy and reel in the inflation. Interest rates are effective in slowing down an economy because if an interest rate is increased it makes it more expensive to buy with credit cards, borrow money or get a mortgage on a home. When this happens the economy will slow and growth will be controlled which in turn reduces inflation. If inflation is low the interest rate will be lowered, it will then be cheaper to borrow money and the economy will be stimulated. "Since Inflation is the single most important factor that affects Interest rates News releases that measure inflation are particularly important for the Forex market."<sup>51</sup>

## 2.9 Importance of Stop Losses:

With so many factors effecting the movement of a currency pairing, having a stop loss in place on every trade is extremely important when establishing a position in forex because just one bad position can result in the loss of a large portion of a person's funds. It is more important to manage one's losses than to manage one's profits. Having a stop loss is part of executing a person's money management system and often gets ignored because people don't like to think that they are about to enter into a losing position. Even if a trader makes money on

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<sup>51</sup> Henry Lui's News Profiteer's Definitive Guide to Fundamental News Trading

the majority of their positions they can still lose all of their profits on just one bad trade if they do not have a stop loss in place. A stop loss is a level of acceptable loss for each trade. A stop loss can protect inexperienced traders from losing money in bad positions and provides a safeguard from any unexpected losses for more experienced traders. As a general rule most people do not want to risk any more than 2-3% of their total account per trade. A person must calculate how much they will gain or lose per pip and then calculate how many pips it will take to reach their 2% threshold. For example, if a trader has \$1000 USD and places an order of 3000 units on EUR/USD, this will give a change of about \$.30 per pip. Assuming the trader is willing to risk 2% of their total account, which is equal to \$20, they must now calculate how many pips it will take to reach a loss of 20 dollars. To do this they divide their allowable loss by the loss per pip which is equal to  $20 / .30$  or about 70 pips.

Sometimes stop losses can be established based on a location on a chart. If a trader finds a level of resistance on a chart they can calculate the number of pips (or distance) from the current market price to the level of resistance. From there if a trader divides their allowable loss by number of pips from the current market price to the level of resistance they will be given a total loss per change of pip. For example if a trader notices a level of resistance 50 pips away from the current market price and they only want to risk \$20 they will accept a loss of \$.4 per pip. The trader can buy 4000 units and have a stop loss at the location of resistance. Using this method a trader can place stop losses at high/low swings, locations of the beginning of a trend or at locations related to Fibonacci retracements.<sup>52</sup>

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<sup>52</sup> Henry Lui's News Profiteer's Definitive Guide to Fundamental News Trading

### 2.10 Resources available for the modern trader:

There are many resources available for the modern forex trader. There are hundreds of websites where you can learn the basics of trading forex, find fundamental and technical analysis, receive expert analysis or research upcoming news releases. It is important to find reliable resources that work with your trading plan and help you to gain an advantage over the rest of the market. News sources like cnn or reuters can be great resource for finding news articles regarding the economic on goings of a nation.

Some experts, such as Henry Lui, produce weekly news letters that provide certain signs to look for in the upcoming trading week. These can be very helpful when planning out your trading strategy for the week but it's important to remember that no expert is infallible. If a forex expert had a "no lose" method for trading they would not have the need to generate income by charging customers for their newsletter. An expert's advice can be a very helpful resource, but it should not be taken as fail safe plan. A trading mentor can be very helpful source of information for a young trader. A mentor can pass on basic trading rules and principles that should always be followed and can help an inexperienced trader avoid common mistakes that many traders inevitably make when they first begin. An alarming 90% of forex traders fail the first time they attempt to trade the market. By arming yourself with the correct combination of forex resources and the basics of stock trading, the success rate in trading increases exponentially.

### 3 Methodology

With the various indicators and investment strategies at hand, it was a difficult process to choose a specific method to follow.

1. The first step was to decide what indicators were going to be used in our time trading. Many practice accounts were explored to decide which would be the most suitable for this project. The most used platforms by the group were Meta Trader 4 and Oanda.
2. This project started with each group member having one hundred thousand dollars to invest and come up with the largest possible profits based on knowledge and understanding of the market. To be able to do this the investor had to keep up to date with the current market news, also known as fundamental analysis, and had to trade using basic rules.
3. To manage a portfolio correctly the investor implemented a stop loss at 2% of his initial investment. This made sure that the investor did not lose an excessive amount of money and that emotions did not make up any reason to trade
4. A set number of daily trades were set up, including lot size, and at what specific points of the day. This discouraged random investments and eliminated opening only one large position instead of a few smaller positions around the same point. Opening more positions allowed for the closing of some trades, while keeping others in the case of a continuation of a trend.
5. Each member concentrated on a different currency and its pairs. This was done to give a larger variety of possibilities to the project. This was an example of how an investor

used multiple options to invest. Always looking at more than one pair of currency is very important to seek more opportunities.

6. Once each pair had been tested with an indicator, the indicator was switched and possibly replaced with another one or two, in the case of using a combination of two indicators.
7. Once each trade was finalized the results were recorded.

For this project, this portfolio management technique was developed and applied to every trade. Having a maximum loss a day and various methods for how each trade had been executed was very important, it allowed for a controlled loss and maximum gain from every trade. It is recommended that each investor has his own investment portfolio.

## 4 Implementation

### 4.1 Choosing Indicators

In order to complete the goals we set in chapter 1 we decided to begin by studying trading indicators. When choosing an indicator you must evaluate the type of chart movement that is occurring at the current point in time. There are several types of indicators such as trend, oscillation and momentum indicators. It is important to use the right type of indicator in the right situations. We decided to use indicators a set of 2 or 3 so that we could confirm the current market trends and not be overwhelmed with information. When picking a set of indicators to use we decided to pick a set that would complement each other and would provide different types of information about the market and not just provide duplicate signals. The following are the indicators that we selected to use to help identify the current trend and help us make better trades.

When we first started trading we decided to start off using a few simple indicators to try and gain experience with using indicators. We started off using Bollinger bands as well as simple moving averages. Bollinger bands are a very powerful indicator because they provide a lot of market information about trend direction and volatility. Bollinger bands were an ideal indicator for our purposes because with just one indicator we could get a lot of information about the current market strength and direction. We also employed simple moving averages because it is a simple and clear price trend indicator. Below is an example of a simple moving average indicator, showing a clear down trend over an 8 hour period. The yellow circle features a location where the candlestick bars extend above the moving average.



This indicates the pairing is over bought and will shortly return to its down trend. Although the pairing is currently in a buy at this time, this location would be a great opportunity to short the EUR/USD pairing because the overall trend is in a sell pattern and the short term pattern suggests that there will be a reversal to the original sell trend soon.



*Figure 4.1: Example of a simple moving average*

At the beginning of our trading simulation we found that there were some issues with the Simple Moving Average indicator. The information it provided lagged a bit because it was calculated based on past market information and sometimes did not predict future market trends. We replaced the simple moving average with the Parabolic SAR indicator. We found this indicator to be very good at following a trend as well as detecting an upcoming trend reverse. The indicator stops and reverses just as the price trend reverses. We really enjoyed

using this indicator because it was really simple to use and provided a very clear buy or sell signal. We typically used this set of trend indicators early in the day between the hours of 9-11am, when volatility was high and strong trends were routinely prevalent. However, we discovered that the Parabolic SAR indicator was a bit inaccurate during market oscillations. As a result of this, we decided we needed to use a different set of indicators for when there were no obvious major market trends.

We decided we needed to accumulate a set of oscillator indicators to use when there were no prevalent market trends. We used CCI and slow stochastic to show the current market oscillations. If the price had reached the end of its trend we were able to identify that it was losing strength. Additionally, these indicators identified the top and bottom of an oscillation channel. We found that when we used the CCI alone it was not completely reliable. However, when it was used along with candlestick reversal patterns it was more dependable. We also used the slow stochastic indicator towards the end of the day when it was most effective at identifying late day oscillations. We found that typically during the hours of 3-5pm the market trends weakened and tended to transform more into oscillations. The graph below is a perfect example of an oscillation trend. Levels of support and resistance can be seen at the red dotted lines. We recommend letting the trend bounce off the levels and establish a strong trend reversal before entering a position. The goal of this is to catch the middle of an oscillation because trying to profit from the entire trend is extremely difficult. It is important to wait for the current candlestick bar to close in the direction of your trend because sometimes a bar will initially start out in the direction of your hypothesized trend, but will close in the opposite direction. This is due to the market makers trapping traders into positions. In order to prevent

this we learned that to wait for the candlestick bar we were analyzing to close and the trend to establish.



*Figure 4.2 Example of an Oscillation pattern*

In the following trade, a classic railroad candle stick indicator was used. This candlestick pattern occurs when many traders quickly enter a bad position, quickly close it and enter into the opposite position. There was a down trend for a short time at which point a sell position was entered. Shortly after this position had been entered the trend retraced to its original upward direction. This was a losing position, but we learned that it is extremely important not to enter into a position that goes against the overall trend. Just because we did not profit monetarily from this position, we do not see it as a negative trade because we were able to learn from our mistakes and understand more about how the market moves.

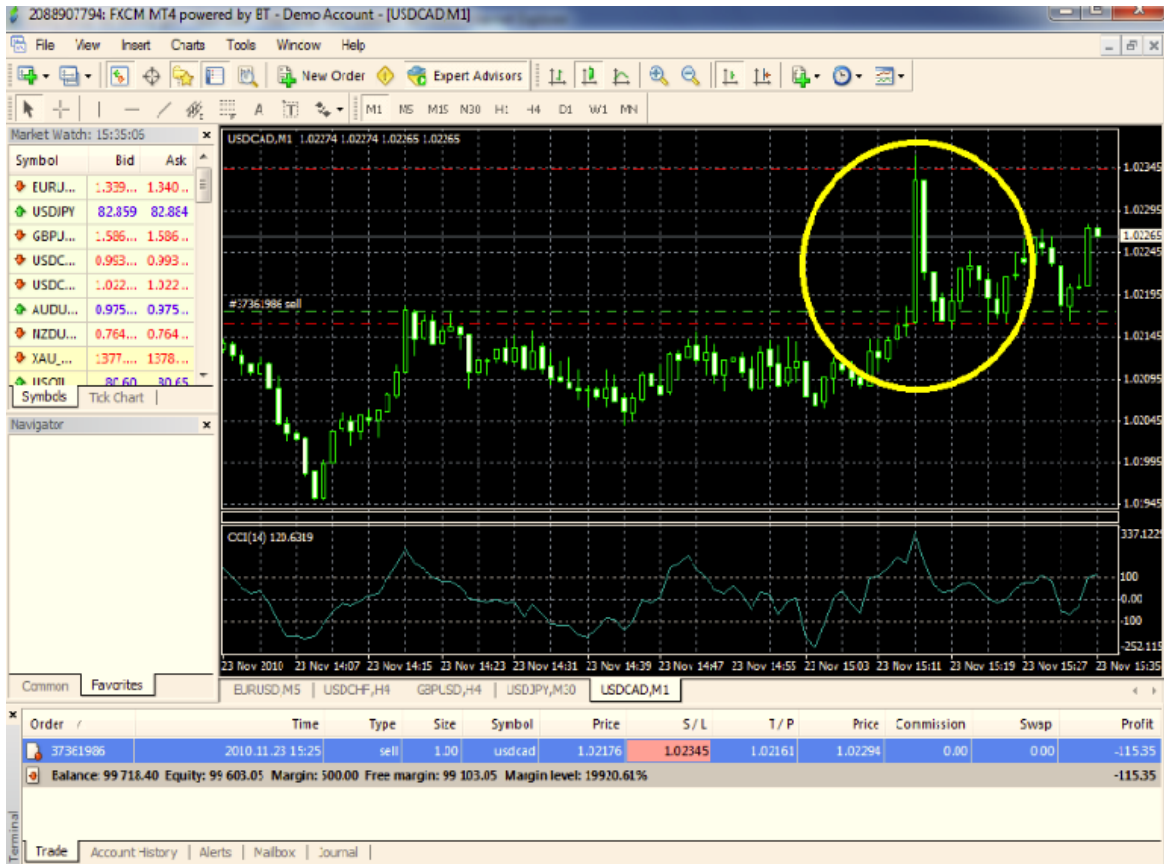


Figure 4.3: Example of Railroad track indicator

## 4.2 Selecting a platform

Once we had learned more about trading indicators we determined the next step in completing our goals was to pick which trading platform we would use during our simulation. We decided to use the Oanda trading platform for our simulation because it had a lot of features that we thought catered to us as novice traders. One of the major reasons why we selected the Oanda trading platform was because of the lot sizes that they allowed their clients to trade with. Most platforms limit their customers to a certain lot size, but Oanda does not set a limit for trade sizes. The fact that they support accounts of any size was important to us because if we wanted to switch from a practice account to a live account, it would most

likely be with a small balance at first. We settled on Oanda's practice trading platform because we wanted to be familiar with their services for when we switched to a live account funded with our own money.

Another benefit of the Oanda platform is the fxNews link which provides up-to-the-minute financial news and analysis from market news providers such as Reuters, Dow Jones International, 4CAST, and UBS Analysis. Having instant access to news releases and market information is vital when trading news releases. Oanda also offers expert analysis that helps to explain the driving force behind market movements. In the analysis section of the Oanda platform they offer tables that show currency analysis, volatility and currency strength comparisons. We also decided to use Oanda because they offered mobile trading applications offered on smart phones. We liked that we could make trades as well as watch price charts at anytime during the day. Oanda was one of the few platforms that offered mobile applications. Another useful feature on the Oanda platform is the forum that they offer. This feature allowed us to post questions that were answered by other Oanda customers. Customers can use the forum to solve technical issues or get market advice.

#### **4. 3 Trading Resources**

Finally we determined that we needed a set of trading resources that we felt would provide reliable trading information to us. With a dependable set of resources we could make informed trades and achieve our goal of maximizing profits. When we started our trading simulation we collected several resources that we felt were reliable that we could use for our market research. The resources were grouped by fundamental and technical resources

based on the type of information that they offered. Our fundamental resources publish news releases that gave us a glimpse of the current economic standings of a nation's economy and currency. We used [cnn.com](http://cnn.com) and [reuter.com](http://reuter.com) as our main sources for economic news releases and announcements. We also used [Forexfactory.com](http://Forexfactory.com) as our forex calendar resource. We used this website to find out what economic announcements were being published each week as well as to identify certain times during the week that we should avoid opening new positions during.

During our simulation we found that technical analysis was more effective for the short term types of trades that we were executing. A popular trading website we used for technical analysis was [Forexpros.com](http://Forexpros.com). It offered a comprehensive summary of technical signals for all of the major currency pairings for time periods of 5 minutes, 10 minutes, hourly and daily. If the signals matched across all four time periods it was a clear sign that a strong chart pattern was present over several time periods. We found that this can be a good method for selecting which currency pairings to trade, it is still necessary to pick out the appropriate locations on the chart to enter a position. We found a combination of mostly technical analysis and some background fundamental research was the most effective method for researching the currency movement of a currency pairing. One of the techniques we implemented was lining up a currency's pairings to see if there was a relation between that currency and the driving force behind. For example, if we all of USD's pairing and noticed a distinct technical trend across all of its pairings we could predict that the USD was the driving force. Once we detected a distinct correlation throughout the pairings we then went to fundament research to find the root force of the movement. Typically we found that the driving currency movement was the result of an

economy report or bank announcement that was recently released that educed a significant strength adjustment of that nation's currency. Since the majority of our trades were only active for a few hours, we mostly used technical analysis and charts patterns to decide when to enter a position and used fundament research to learn why a chart was moving in the manner that it was.

One valuable resource what we began to use during the later part of our simulation was weekly reports issued by trading experts. At the beginning of every week fundamental reports are issued that detail the certain signs to look for during the upcoming week of trading. The reports list all of the upcoming economic announcements that are scheduled for the week and give their expected figure. The newsletters advise their readers how to trade based on how the actual reported compares to the estimated figure. We found these newsletters to be useful because it helped us key into which announcements are more important and should receive more of our attention. We were careful not to fully buy into the advice of the newsletters because no expert is perfect in their predictions and their advice is never fool proof. In conclusion we found that a mix of mostly technical and some fundamental research was the most effective method for our short term trading.

## 5 Results and conclusion

When starting to trade it is important to research every aspect of what was bought or sold. Knowing the market that is to be invested in is impertaive in order to succed. There are many tools available to help make these descisions.

When trading on Forex is it important to remember that it is a very quick and changing market, where it is possible to loose a large amount of money in a small period of time. Although it has high risk, a smart investor will be able to overcome by using an inestement plan, indicators and the corredt platform for the situation.

After experimentation and research, there was one reoccurring thought and trend that was evident in order to be successful. This notion was that the trader should use multiple trading tools at a time to get the best outcome. Apart from using multiple trading tools, the trader should be comfortable with all of them and be able to trade with all, or most of them.

One of the most important tools that was used in the project was the management portfolio plan. It is very important to have one in place such that it prevents majors losses and has a higher success rate when used properly. Every trader should have his own management plan, but it is encouraged to follow the advice of experts and teachers when first beginning to trade.



Another very important aspect of trading is being aware of what is happening in the global market at the time. Being aware of international news can give a very strong push in the right direction when it come to trading. When knowing what governments around the world are thinking, it is possible to predict to a certain extent how the currency of that country will be moving in the near future.

It was also seen that using various indicators was helpful, however it is important to never rely on a single indicator for every trade. Every indicator had a time where it worked better than others, and on the other hand it had some times where it did not accurately represent the market. Some indicators, such as the slow stochastic, work better during oscillating trends, but do not accurately predict trends when there are large movements.

Finally, from this project we were able to find that there is never a single right way to trade. The market fluctuates everyday, and although some trends can be followed and recorded, these should not be taken for granted. Forex would not exist if people were able to distinctly recognize patterns in the market and trade based on these patterns. If it was easy to trade, everyone would be a millionaire.

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## 7 Appendices

### Appendix A: Indicator Research (Example of Technical Analysis)

This week I investigated certain indicators that hint that there would be a reversal in the current trend. Recognizing when a trend is going to reverse is important because it can alert you when to enter a trade or when to close your current position. Several important indicators to look for are the CCI Indicator, MACD, the spinning top, and railroad tracks. If several of these indicators are showing at the same time, the probability for a change in trend is increased. Although there is no perfect indicator, these three indicators are an accurate way to catch a trend reversal before it happens.

The first indicator to use to try and spot a trend reversal is the CCI indicator.” An oscillator used in technical analysis to help determine when an investment vehicle has been overbought and oversold.”<sup>53</sup> It is calculated by subtracting the forex price minus the Moving Average, which is then divided by the standard deviation. The CCI is used to identify cyclical trends. When the indicator hits a certain mark like 200 investors usually wait for the indicator to retreat back to 100 before entering a reversal trend. The CCI gives realistic evidence to approximate changes in the direction of price movement.

The MACD is an important indicator to help identify who is driving the price movement, either the buyers or the sellers. “When you are in an upward movement and you see the MACD histogram shortening, it is a sign that the buyers are losing strength and a possible reversal is

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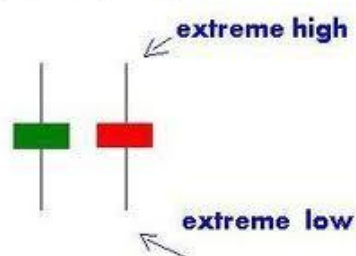
<sup>53</sup> <http://www.investopedia.com/terms/c/commoditychannelindex.asp>

coming."<sup>54</sup> If you are in a downward movement and you see the bars of the histogram, it is sign that the sellers are losing strength while the buyers are gaining strength.



Along with these two indicators certain candle stick patterns can be signs of a trend reversal. The first is called a spinning top. This is when there is a short body and long wicks. This is an indicator that there is indecision between the sellers and buys. This indicates the end of a trend because the support that was driving the trend is now weakening.

### Spinning Tops



<sup>54</sup> <http://www.forexindicator.org/my-favourite-forex-reversal-indicators.html>

The final indicator that can hint that a trend reversal is looming is called the railroad tracks. That is when a long opposite candle follow each other. It shows that a high volume of people enter a position and then are quickly closing their positions and enter the opposite position.

This past week I used several of these indicators to try and predict trend reversals and enter a position just before they market swung. This is the screen shot of the chart I was using to predict the price movement of USD/JPY. Unfortunately, I bought the pairing at the peak of an uptrend and had a loss for awhile. However, I maintained my position for several days this week and eventually was able to make a profit on this position. I entered my position because the bars in the MACD were not shortening and the CCI still had some room to grow in my opinion. I did not see any spinning tops or railroad tracks so I felt the uptrend would continue. Over the short term my prediction was incorrect which reinforced that indicators are not perfect all the time.



I had read from several forex news outlets including Reuters and Forex live that they were prediction the yen to strength to the 85.00 level. That prediction did not come true and the pair met resistance around \$83.50. I did not have a very successful week because I was waiting for this pair to break its resistance level and hit the 85.00 mark which it never did. I was able to limit my losses by placing stop loss limits on all of my positions, that way I did not lose too much of my total profit. I am currently only down about \$400 which can be easily recovered with some smarty decisions. Hopefully, this coming week will provide better opportunities to earn money and gain back my losses.

## Appendix B: EURO UPDATES (Examples of Fundamental Research)

November 16, 2010

The euro dramatically fell to a seven week low against the USD on Tuesday after an amounting fear that the European debts will increase. On the other side of the Atlantic, the USD rose to a seven week high against a large amount of currencies as low stock and commodities prices drove the USD sharply upwards. The euro fell below \$1.35 and will, in the eyes of many, stay weak in the near term as debts increase in Europe and insecurity over the resolution of these problems increase. Euro officials are thinking about a bailout package of 80 billion to 100 billion Euros for Ireland. Ireland has come under fire over the increasing debt, as Euro officials warn that the entire European Union is in danger. News that Greece will mostly probably miss its fiscal targets this year is not helping the Euros cause at all. There seems to be an increasing fear of risk in the Euro market as these debts continue to stack up. The euro hit \$1.349, the weakest it has been since it hit that on September 28<sup>th</sup>. The agreement of this bailout plan would help the Euro tremendously, as it would reassure many of the handling of the debt.

November 17, 2010

The euro was at a seven week low on Tuesday carrying over into Wednesday, crippled by the Irish debt and the lack of solution to it. A plan to bail out Ireland was laid down by

various European banks, but Ireland has yet to decide on its position in this plan. This didn't really help the Euro as the cost of helping out Ireland and lingering debt struggles around Europe remain in the minds of investors. These debt problems could possibly spread to Portugal and possibly other weak countries, further scaring off investors. Irish talks with the IMF are to take place on Thursday. The euro rose slightly to \$1.350, coming off of a seven-week low of \$1.344 on Tuesday.

November 18, 2010

The euro continues to hold on to the hopes that Ireland is near a deal to bailout the depleted banks and cut the budget deficit. The euro did stop short of breaking above major resistance. The euro rose from these hopes, but also got a small boost after the Federal Reserve defended against the heavy criticism of the bond buying program. The bank argued that it showed no signs of backing away from the program. Experts have warned that the euro was not saved just yet. The Irish debt continues to mount up, and it is threatening to spill over to other struggling European countries such as Portugal. The euro is bouncing back nicely from a seven week low on Tuesday, and it looks as if it will rise even more with the bailout plan in the works. The worst for the Euro seems to be over. The Euro needs to get above resistance at \$1.3750 in order to really show some great improvement.

November 19, 2010

The Euro kept rising on Friday, gaining steadily for a third straight day against the USD. Investors are growing more and more confident in the diffusing of Ireland's lingering debt



crisis. These gains in the Euro may be temporary as investors are growing afraid that Ireland's debt problems can spread to other countries in the European Union. The persistent hopes that Ireland was nearing an agreement for a bailout package in the range of 80- 90 billions of Euros from the European Union and the International Monetary Fund had helped the Euro go slightly above \$1.37. Traders and investors have stated that this level is very likely to stay at \$1.37 until the bailout package is negotiated in full. The deal to help Ireland out with its depleted banks is planned to be released early next week. There will also be a fiscal plan to save billions of euros will also be released at the same time.

November 21, 2010

After an Irish plea for an international bailout this Monday in order to alleviate its banking and budget woes, the euro rose sharply. This is a great help and it counters a major decrease that had devalued the currency in the last month. The euro went up in value to as high as around \$1.374 going up from \$1.36 at the NYSE last Friday. The next goal for the euro to rise above can be seen at \$1.3750 and above that, the euro faces \$1.3860. This level is a 50 percent retracement from the fall. According to Richard Grace, chief currency strategist at the Commonwealth Bank in Sydney, "We could see it back up to \$1.3860 over the next 24-48 hours." Many traders are patiently observing the market and waiting to see how European markets would react to the Irish bailout, before deciding on whether to push the euro even higher. In some people's view, the Euro rally will continue steadily as this news sinks in around the troubled European markets. The negotiations about the size of Ireland's bailout package by the European Union and the International Monetary Fund have not taken place and are very

likely to be smaller than Greece's. Greece's bailout package was given last May, and was in the ballpark of 110 billion Euros.

November 23, 2010

The euro dipped again, and fell under pressure in Asia as Irish political uncertainty and worries about other European debts killed potential optimism over the Irish bailout plan. Many investors are not convinced that the Irish bailout is going to prevent other struggling economies to ask for a bailout plan of their own. The Portuguese crisis is getting bigger and bigger, resulting in a debate on whether it needs a bailout as well. Because of this uncertainty, the Euro fell to \$1.3551, a slight rise from yesterday.

November 24, 2010

The euro dipped near a two month low as debts from Ireland were thought to spill onto other struggling economies, namely Portugal and Spain. Portugal and now Spain are seen as about to be in real danger, while Ireland's bailout plan has been criticized for assuming great economic growth. Trade was very low on Wednesday, due to Thanksgiving on Thursday. The Euro fell to \$1.3312. It hit a two month low of \$1.3284 earlier in the day. Against the Yen, the euro fell to ¥111.15 after having fallen to ¥110.32 on Wednesday. Many investors view no point in buying Euro for the day.

November 25, 2010

The euro stayed extremely weak on Thanksgiving, staying very close to around a two month low against the USD. The European debt crisis is a predominant problem in the global market, and it showed little, if any, signs of lessening. Investors remained very worried about the spread of this debt to bigger European economies. Portugal and Spain appear to be the next in line for worry, as the Irish problems seem to show a sign of resolve. Forex was very light in volume, due to the American holiday of Thanksgiving. "The Euro remains a sell into rallies and not a buy on dips," said Paul Mackel, a director of currency strategy at HSBC. The Euro went up to \$1.334 after hitting a low at \$1.3287. The Euro is expected to fall towards \$1.308. The European Commission stated on Thursday that there were no discussions of more bailout plans for struggling economies.

November 26, 2010

The Euro fell to a two month low against the USD on Friday as investors fear that Portugal needs a bailout plan similar to the Irish plan. Many investors are shying away from the Euro even though an Irish plan has been set in motion, as Spain and Portugal are struggling heavily with debts of their own. Portuguese and Spanish officials are denying that they are reaching out for help and a bailout plan of their own. Increased pressure on the euro has surfaced after big countries such as Spain and Italy are beginning to show signs of a debt crisis. The euro will remain under pressure for a while as there are no short term recovery plans for the moment. The euro fell to \$1.3217, having dropped to a low of \$1.32.

November 28, 2010

The Euro dropped to a two month low against the USD on Monday as the world market looked past the Irish bailout plan and looked at other crumbling European economies.

Financial officials in Europe endorsed an €85 billion bailout package to help Ireland cover bad bank debts. This plan will cut a huge budget deficit and also includes an outline of a permanent crisis resolution system which makes bond holders share the burden of restructuring debt after 2013. The Euro rose sharply in the Asian trade, right after the bailout package was endorsed. A good trading source (Reuters) said that the move appeared to come from buying from one party and then it quickly fizzled out. A big fear for investors is the lack of a game plan from the European Union to keep the Irish debts from spilling over to other European countries like Portugal, and a fear that the bailout plan will not work after the problem was not resolved in Greece after its bail out earlier this year. The focus of the European market is moving onto Spain and Portugal.

November 30<sup>th</sup>, 2010

The Euro fell heavily, falling down to a 2 and a half month low. The Irish bailout plan failed to dispel fears about European debt, as the Euro fell to \$1.2969, the lowest since mid-September.

There seems to be huge Spanish and Portuguese debt piling up, as well as German debt. The European credit market is basically in a panic. The European Central Bank needs to assume some kind of action against this. The Central Bank meeting this Thursday is a chance to relieve investor's fears by producing a concrete plan to deal with the debts.

December 1<sup>st</sup>, 2010

The Euro rose on Wednesday, breaking a 3 day falling streak. The sudden rise was based mainly on the European Central Bank taking big steps to ease Europe's debt crisis at a meeting on Thursday. The Euro remained weak after ongoing fears about Europe's fiscal problems. A U.S. Treasury Department spokesman said on Wednesday that the United States is not discussing an extra commitment of funds for a European stabilization fund right now. The Central Bank is expected to keep interest rates unchanged and may announce an extension of crisis support measures beyond their scheduled expiration in mid-January. "I personally think the market will be disappointed tomorrow because the lack of a consensus within the ECB about bond purchases will cause it to deliver less than what the market is hoping for," said Aston Chan, portfolio manager at GLC, a \$1.2 billion London-based global macro hedge fund. Germany doubts that it can fund any more bailouts which may affect the Euro's value less. At the NYSE, the euro was at \$1.3117 and staying up above the \$1.30 region.

December 2<sup>nd</sup>, 2010

The Euro remained on the up rise, especially since the European Central bank buying debts from the peripheral European nations. The most important focus of the global market is on the US job and payroll, which some believe to be good news for the US. The euro stayed at \$1.3210, doing much better than last week's two month low. The euro is believed to have bottomed out and continues on a stable trend toward \$1.34-35. Many traders have said the

Central Bank was buying Portuguese and Irish debt. This is going to help the market get over the debt insecurity that was present last week. As many traders expected, the Central Bank extended "nonstandard provisions", in which they commit to provide unlimited one-week, one-month and three-month funding for vulnerable banks until at least April.

December 3<sup>rd</sup>, 2010

The Euro went up against the USD on Friday after a poor showing in the U.S. jobs data. The euro remains unstable though as the debts continue to pile up in Europe. The USD dropped after the Labor Department data showed U.S. payrolls rose 39,000 in November. This number fell way short of the original estimate 140,000 new jobs. The U.S. unemployment rate also increased to 9.8 percent, increasing the EUR/USD value. Many investors see the Euro as only temporarily rising, and not to establish too many buying positions. Some also see the euro ending next week unchanged against the USD. Many people are considering taking their positions until the end of the year. The European countries remain immersed in debt, which should keep the euro's downtrend. Ireland may have been bailed out, but investors are still very worried about the next euro-area country to require assistance.

## Appendix C: Barron's Review of Trading Platforms

Choice Trade	www.choicetrade.com	1-877-731-9114
Cobra Trading	www.cobratrading.com	1-877-792-6272
E*TRADE Securities	www.etrade.com	1-800-ETRADE-1
Fidelity.com	www.fidelity.com	1-800-FIDELITY
Fidelity Active Trader Pro	www.fidelity.com	1-800-FIDELITY
Firstrade	www.firstrade.com	1-800-869-8800
Interactive Brokers	www.interactivebrokers.com	1-877-442 2757
Just2Trade	www.just2trade.com	1-877-206-2274 1-888-LSPD- OR 1-646-393-4800
Lightspeed Trading	www.lightspeed.com	1-866-628-3001
MB Trading	www.mbtrading.com	1-800-872-0711
Muriel Siebert	www.siebertnet.com	1-877-653-2500
OptionsHouse	www.optionshouse.com	1-888-280-8020
optionsXpress	www.optionsxpress.com	1-800-619-7283
Scottrade	www.scottrade.com	1-800-619-7283
Scottrade Elite	www.scottradeelite.com	1-212-668-8686
SogoTrade	www.sogotrade.com	1-800-669-3900
TD AMERITRADE	www.tdameritrade.com	1-800-228-4216
Terra Nova	http://www.tnfg.com	1-866-839-1100
thinkorswim	www.thinkorswim.com	1-877-495-KING (5464)
TradeKing	www.tradeking.com	1-877-598-3190
tradeMONSTER	www.trademonster.com	1-800-808-9336 or 1-954-652-7677
TradeStation Securities	www.TradeStation.com www.maia.zecco.com and	
Zecco	www.zecco.com	1-877-700-7862

For the complete table access the following link:

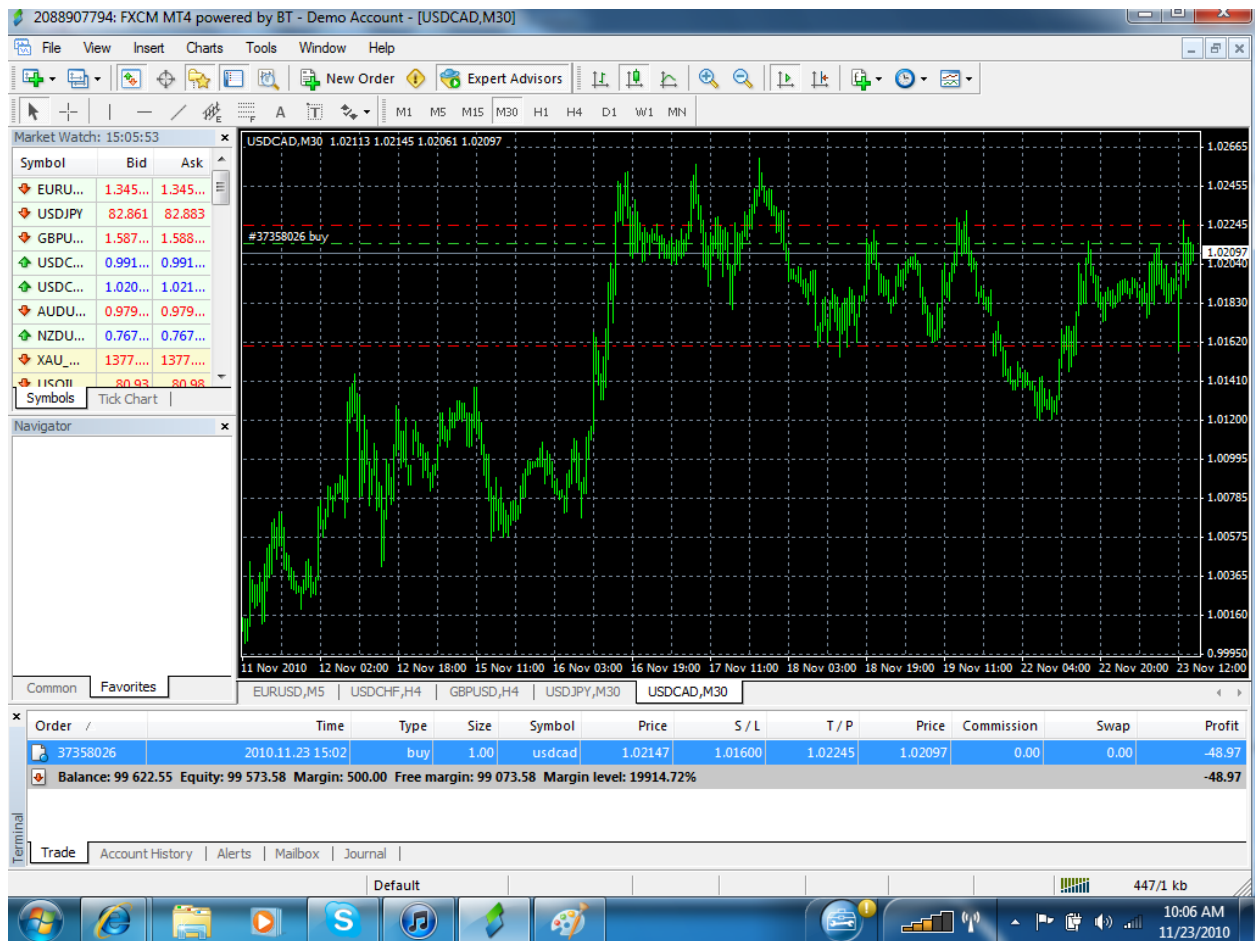
<http://online.barrons.com/article/SB126844977199261489.html>

## Appendix D: Example of a Trading Journal

### Trading Journal for Tuesday 11/23/2010

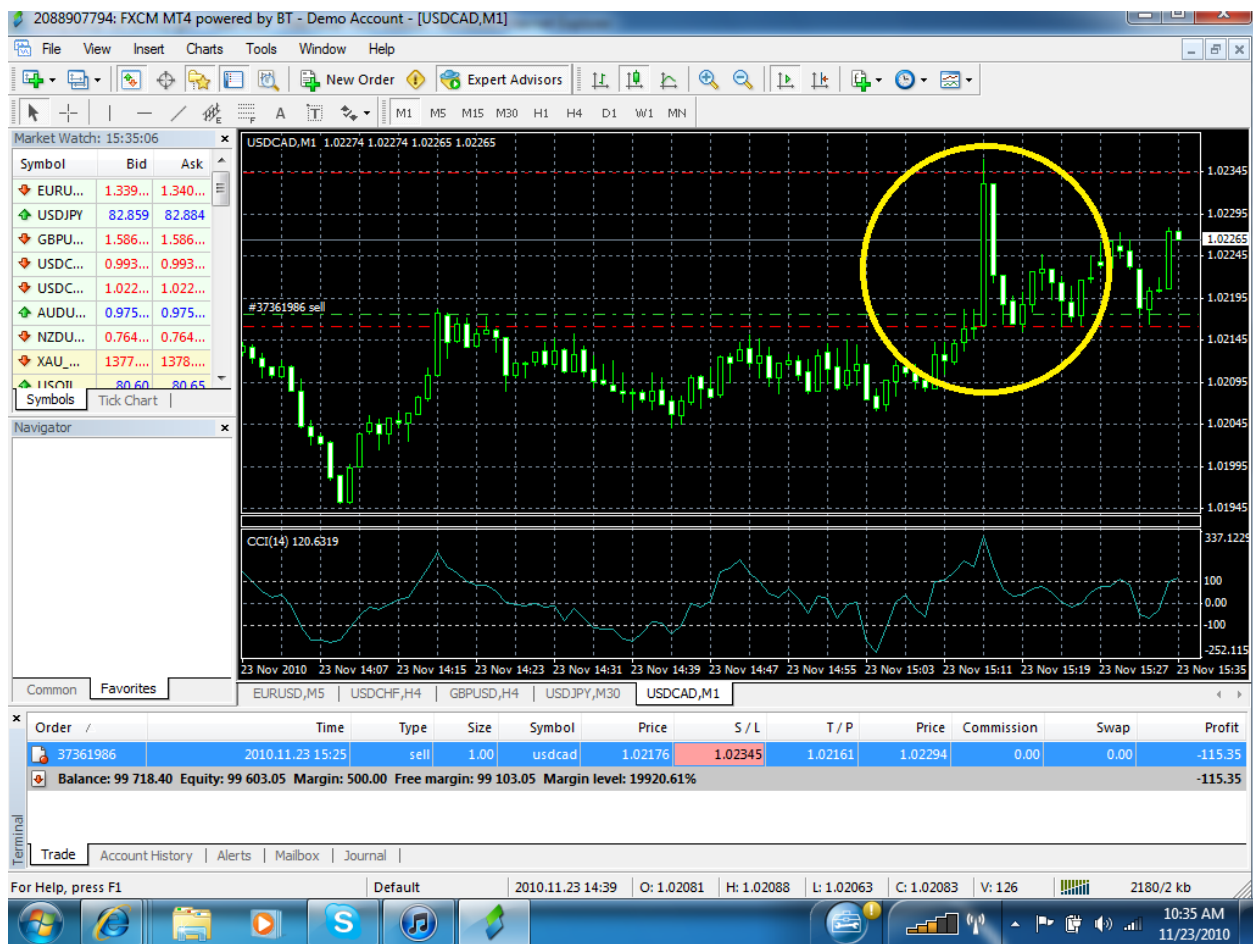
I made several trades to buy the USD/CAD because it has been in an ascending trend all day long. I read several reports that said this pairing was a strong buy today and I felt like this present a strong opportunity to make a profit. I made two trading where I bought usd/cad one was for 1 lot and the other was for .5 lots. The first trade of 1 lot was very profitable and I closed it with a profit of about \$95. The .5 lot trade was also successful and I closed it with about 14 dollars profit. It had reached a about \$30 profit level and retreaded a bit and I decided to close the position before I lost too much profit. As you can see from this screen shot there was an ascending trend in the morning and I set a Take profit at about the 1.022 level and had a stop loss at the 1.016 level. This allowed for a little price oscillation and also gave the ratio an opportunity to grow. This was my most successful trade so far.





A little later in the morning I noticed a sign that I felt that there would be a trend reversal. I saw that there were two very long railroad tracks. This is a sign of traders getting into the wrong position and the two long opposite candles are formed as traders quickly exit their wrong position and enter the opposite position. You can see the two tracks inside the yellow circle in the picture below I shorted USD/CAD pairing and sold 1 lot. After doing this I realized it may not have been the smartest move because I was betting against the overall ascending price movement that was occurring. This is something Prof. Hakim recently mentioned during a recent weekly meeting to avoiding doing this. To compensate for my mistake I set my stop loss

and take profit at very tight levels for two main reasons. First, I didn't want to lose a lot of money on a bad position and second I set the T/P level at a very tight level so that if I did end up making a profit it would close the position before my profit retreated back into the negatives. I was ok with taking a small profit on this position because I wasn't expecting it to turn out very good for me. Luckily the price level dipped enough to trigger my T/P order and I was about to take a \$14 dollar profit. Today has been a very good day for me because I have entered 4 positions and have profited on all for positions for a total of about +\$150.



## Appendix E: Example of a Gartman letter

Below is a January edition of a Gartman letter which is a weekly market outlook report:



**THE GARTMAN LETTER L.C.**

**Monday, January 24th, 2011**

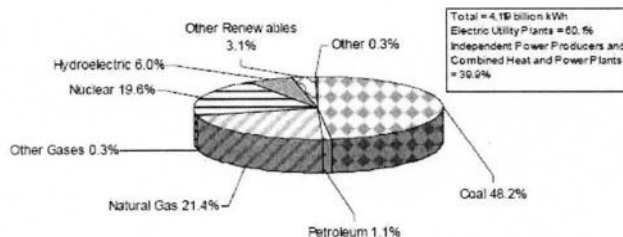
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### OVERNIGHT NEWS:

## THE US DOLLAR CONTINUES GENERALLY TO WEAKEN

with the world focusing its attention of course upon the EUR/dollar rate primarily, and indeed the dollar has weakened and has weakened quite sharply in the course of the past five or six trading sessions. It was only the first week of the



year when the EUR had traded down to 1.2900 and the news out of Europe was of continuing political upheaval within the Union and of worse-than-expected economic data. Since, the view of all things European has turned on the proverbial dime, and now it is as if all things political and all things economic in Europe have been and shall be bright and shiny whilst all things North American are dulled and disdainful. The psychology of the foreign exchange market is schizophrenic always and everywhere, and it is especially so at the turns of the year.

**WE'RE IN OHIO THIS MORNING:** Mr. Gartman is in Cuyahoga Falls, Ohio this morning, taking care of family business and then attending the University of Akron Foundation investment committee meeting. TGL is in its regular format at its regular time, but Mr. Gartman will not be available by telephone, although he will be answering e-mails when possible. He is turning this evening.

### ELECTRICITY GENERATION IN THE US BY FUEL

**SOURCE:** This fascinating chart details the fuels used in the US to generate electricity: Coal trumps'em all, followed by natural gas, followed by nuclear.

The week will focus on two things: the President's State of the Union Address tomorrow evening and the FOMC meeting that begins tomorrow afternoon and

ends Wednesday afternoon. Let's take the latter concern first, noting that this is the first meeting of the new year of course and that means a shifting of the rotation of the regional federal reserve bank Presidents to the position of "voting member." Out are Cleveland's President; Boston's President; St. Louis' President and the President of the Kansas City Federal Reserve; "in" are the Presidents from Chicago; Philadelphia; Dallas and Minneapolis. The "In's" are Mr. Charles Evans from Chicago; Mr. Charles Plosser from Philadelphia; Mr. Richard Fisher from Dallas and Mr. Narayana Kocherlakota from Minneapolis.

### MARCH KC HARD RED WINTER WHEAT: A Bull

*In Full Regalia: This is what a bull market looks like when the fundamentals and the technicals are in full gear and well meshed. We need to buy weakness back toward or even merely near this trend line.*

Much debate within the economic world has of late centred upon what we all expect these new rotational members of the FOMC to do and simply put we expect the composition of the FOMC to have changed very little. We

can reasonably expect Chicago and Boston to vote with

the majority and most often with the Chairman; we can expect Dallas to be the gentleman most likely to dissent for the next several meetings and offer up the most "hawkish" of postures, and we can expect Minneapolis to be the most likely "dove" of the four new voters. Mr. Fisher of Dallas will be the hawk, and his background is the most interesting of the group given that he is the only voter in the rotation without a Ph.D in economics. He has an MBA instead, and interestingly he came from the world of money management (he had his own money management firm many years ago) and from the foreign exchange and debt trading world, for he traded both back in the 70's when he began his career in the capital markets.

Concerning recent statements of consequence by these new voters, we note today comments from Mr. Plosser and Dr. Kocherlakota. Dr. Plosser, before becoming the President of the Federal Reserve Bank of Chicago, was a professor of economics at the University of Rochester and prior to that was a senior research associate at the Rochester Center for Economic Research in the university's College of Arts and Science. He was also previously a research associate at the National Bureau of Economic Research in Cambridge, Massachusetts... the folks responsible for "dating" the US recession and expansion cycles. He has also been a visiting scholar at the Bank of England and the Federal Reserve Bank of Minneapolis. Dr Plosser earned his Ph.D. in economics and an M.B.A. degree from the University of Chicago, and he received a bachelor's degree in engineering from Vanderbilt University.

In a recent interview with Bloomberg TV, Dr. Plosser said regarding future Federal Reserve policies and the propensity on the Fed to ease or tighten in the near future that

*It's premature to presume the answer to that one way or another [for] a lot will depend on how the data begin to unfold over the next several months as to whether or not we think it's necessary, whether the efficacy of the policy is doing what we thought it would do, whether we continue to think it's necessary....It's way too early for us to sort of read too much into any of this right now....We need to let a little time pass and try to do a*

*more measured assessment of what the effects of this policy are, and what they might be, and the path of the economy going forward.*

In other words, if he did know how he was going to vote he was not going to tell anyone, or perhaps he is as confused about the future as are we and as are most people, including the most sophisticated economists. If we accept Dr. Plosser's statement to Bloomberg TV as "gospel," then we can assume that his first votes shall be to hold to the status quo.

Turning to Dr. Kocherlakota of Minneapolis, who is also a Ph.D in economics from the University of Chicago, we have yet another ex-university professor of economics who's taught at the University of Iowa; at Stanford and at the University of Minnesota. We find it interesting that Dr. Kocherlakota lived for much of his early life in Manitoba, Canada and so we trust he shall bring a "Canadian" perspective to the Fed that might otherwise have been missing previously. As one would expect of a Ph.D. in economics, Dr. Kocherlakota has been a prolific writer of articles for various economic journals and his focus has been upon employment and taxation.

Dr. Kocherlakota has been the most vocal "dove" in recent years and we expect his votes to err upon the further side of easier rather than tighter monetary policies going forward. Likely his views and that of Mr. Fishers shall be at odds, with Dr. Kocherlakota agreeing with Dr. Bernanke's decision to expand the first round of quantitative easing into what we now refer to as QEII.

We look for this first meeting of the newly constituted FOMC to end its two assessment of the economy by holding policy steady and we look for Mr. Fisher to dissent from that decision. There will be no policy change; there shall be very little... if any change at all... in the language of the post-meeting communiqué, and the world will neither breathe a sigh of relief nor take issue too gravely with the non-decision we expect to be announced Wednesday afternoon. Simply put, this is the first vote, and it is a vote that takes place the day after the President speaks from the well of the House floor to give his State of the Union address. Given the Fed's normal posture of being as far above politics as it can

be, and given the fact that no one really knows what the President is to say tomorrow evening, voting to do nothing by the exiting and the new FOMC voting members is the proper and logical vote:

Mkt	01/24 Current	01/21 Prev	US\$Change
Japan	82.80	82.85	- .05 Yen
EC	1.3575	1.3525	- .50 Cents
Switz	.9605	.9640	- .35 Centimes
UK	1.5965	1.5910	- .55 Pence
C\$	.9955	.9970	- .15 Cents
A \$	.9895	.9860	- .35 Cents
NZ\$	.7585	.7545	- .40 Cents
Mexico	12.06	12.08	- .02 Centavos
Brazil	1.6760	1.6720	+ .40 Centavos
Russia	29.88	29.94	- .06 Rubles
China	6.5885	6.5865	+ .20 Renminbi
India	45.57	45.45	+ .12 Rupees

Regarding the economic news this week, of course we've the FOMC meetings tomorrow and Wednesday. Today is a very quiet day with little if any economic news here in the US. Tomorrow, besides the first day of the FOMC meeting we'll see Goldman Sachs' monthly report of store sales and the Conference Board's figure on Consumer Confidence for January... which has been going spot-on-sideways for the past half year or more. Wednesday we shall have New Home Sales for December, and all one can say about new home sales is that they've been in the most severe, the most well defined, the most daunting of bear markets since '06 and we can only hope that that bear market is about to turn for the better rather than the continual worse. Oh, and of course on Wednesday we'll have the regularly scheduled DOE crude and products inventories. Thursday is Durable Goods Orders for December, and as always we can expect volatility from this figure if one can expect nothing else. Further, and although no one seems to pay heed to this figure, the Federal Reserve Bank of St. Louis shall release its weekly figures on Money supply. Finally, Friday we shall have the first look at GDP for the 4<sup>th</sup>

quarter, and the consensus at this point is for an increase of something on the order of +3.5%.

Regarding the Fed St. Louis data, we note that the adjusted monetary base has grown not-at-all in the course of the past year, and so despite the great wailing and gnashing of teeth by many over the too-massive and far-too-swift growth of the monetary aggregates we ask, "Where is that growth to be seen?" Clearly it is not being seen any longer in this, the most basic and the most powerful of all of the aggregates. Yes, the base grew dramatically in '08 and '09, but in '10 it grew not all at all, and in the first three weeks of '11 it has followed '10's lead.

Finally just as we were getting ready to transmit news was coming across the tape that the Central Bank of Saudi Arabia has said that the US dollar has served its purpose well as the world's reserve currency. Obviously more shall follow this statement, but on balance this has to be viewed very bullish for the dollar and rather bearishly for the EUR and perhaps even for gold.

## COMMODITY PRICES ARE ALL QUITE STRONG,

and that even includes the precious metals this morning which have been fighting a bearish trend since the start of this year and of which we remain bullish, but of which we've reduced our bullish exposure materially over the course of two and three weeks ago. Much is being made of the fact that the gold ETFs enjoyed a sizeable increase in their "open interest" last week and we supposed much should be made of that for certainly it is of some support and some real solace to the aggressive gold market bulls that still populate the arena. However, do we believe that the correction has run its course and that suddenly the health of the gold market specifically and the precious metals' markets generally have been restored just because the sum of gold in GLD or the



restored just because the sum of gold in GLD or the

other ETFs has risen? No we do not, and we trust we are clear on this issue.

The chart the page previous of spot gold in US dollar terms tells a very obvious story of a very, very well defined upward sloping trend line that should and likely will offer strong support at the \$1270-\$1290 level. However, it also tells a story of a huge sum of "distribution" at the \$1390-\$1425 level that has to yet be digested. We think the odds favour continued weakness rather than strength until such time as the better defined upward sloping trend line can offer what support it should. We shall be patient then, owing our "residual, insurance" position in gold and nothing more. We're comfortable there.

We have included another interesting chart this page of the precious metals markets, and this time it is of palladium predicated in EUR terms. Auto sales are strong around the world, and they shall be rising even more swiftly in the months and years ahead in India, in China, in S. America and in Africa... and as they do the demand for platinum and palladium shall rise for these metals are still needed in catalytic convertors to reduce auto exhaust emissions. Being long of palladium in EUR terms is a bet on continued global economic growth and a bet against the EUR at the same time, and those are bets we'd not be averse to taking on, and likely will soon:

	01/24	01/21	
Gold	1348.9	1341.4	+ 7.50
Silver	27.82	27.13	+ .69
Pallad	824.50	805.00	+ 19.50
Plat	1828.0	1802.0	+ 26.00
GSR	48.50	49.45	- .95
DJ/UBS	161.92	160.96	+ 0.6%
Reuters	333.99	331.90	+ 0.6%

Moving on to the grain markets, obviously we are angry with ourselves for becoming even modestly concerned about the validity, continuity and/or the veracity of the bull market in wheat. The chart of Kansas City hard red

winter wheat in the lead position this morning at the bottom left of p.1 is of a commodity bull market in full regalia. The long term trend is up; the short term trend is up and weakness is to be bought far more aggressively than strength is to be sold into. We sold strength mid-week last week and it was all too clearly wrong to have done so. Therefore, now we have no choice but to try to find some point at which we can replace that which we sold.

Too, the problems of flooding in Australia seem never to recede, if we can be forgiven this horrid pun. Now we are seeing what small sums of soft red winter wheat produced in southeast Australia are either destroyed entirely or materially at risk. This is moving to narrow the premium that KC HRW wheat had over SRW, but we remain bullish of KC wheat given its dominance in world wheat trade.

We came across a point of interest last week in global wheat trade that we'd no idea about and which we think would win a large number of "bar bets" on the CBOT or the KCBOT: Afghanistan is now the largest flour importing country in the world. Last year, Afghanistan imported 1.75 million tonnes of flour, accounting for 13% of the world's total flour exports. Iraq, we are told, now ranks 3rd or 4<sup>th</sup> in total flour imports. The "Iraqi thing" we can almost understand, but Afghanistan as the leader of global flour imports caught us wholly off guard.

## ENERGY PRICES ARE VERY STRANGLY MIXED

for WTI crude is weak... and in some instances materially so... while Brent crude is higher and nat-gas is strongly so. We know few things in this world this morning about which we are certain but we are certain that the damage wrought upon the trading community in general and the energy trading world specifically as the WTI/Brent relationship has continued to widen and widen and widen some more in favour of Brent is massive indeed. The front month spread is now out to \$8.50, and we find it interesting that that is where the Feb WTI/Brent spread went out to in its final sessions. Some thought this spread illogically wide when it traded to \$4.00/barrel. Some joined the "game"



when the spread move to \$5/bbl. Some added to their losing positions as it made its way to \$6/bbl and now that it is out to \$8.50 they are mired in huge, shocking, career ending and bankruptcy making positions. This is and has been the "Roach Motel" trade: you are let in but you are never let back out:

Mar WTI	down	62	89.40-45
Apr WTI	down	46	90.92-97
May WTI	down	28	92.23-28
Jun WTI	down	11	93.36-41
Jul WTI	up	1	94.08-14
Aug WTI	up	6	94.53-58
Sep WTI	up	10	95.87-92
OPEC Basket \$93.99 01/19			
Henry Hub Nat-gas \$4.43			

As a point of interest, approximately 70% of the world's remaining provable reserves of crude oil are in the hands of OPEC nations. This is of course problematic for almost all Western nations for the West relies upon OPEC production... except for the US and Canada, for we must also remember that nearly half of the "free" oil in the world is trapped in Canada's oil sands. This is really quite an astonishing statistic, but if you ask most American about which nation they think we are most seriously beholden to a supplier of foreign crude oil they will respond almost universally in unison, Saudi Arabia. The truth is that we in the US are beholden to Canada. Sadly, we seem not to be aware of that fact nor are we willing to act upon that fact even when we are told of the facts involved.

There is a very real need for further pipelines to bring tar sands crude to the US, but one of the pipelines needed.... The Keystone Pipeline that would bring crude down from Hardisty, Alberta to Cushing and then on to the Gulf of Mexico... is being opposed by a strange coalition of environmentalists and farmers in Nebraska... the latter who really should know better, but apparently don't. The government in Alberta is angry enough about the intransigence on the part of America regarding this pipeline that it is moving ahead with a pipeline to carry crude west from Alberta to Kitimat, British Columbia. Oil transported west to port facilities at Kitimat may make its way to China and other Asian countries rather than to the US, thus increasing US dependence upon Saudi Arabia at a time we wish to

reduce that exposure. Such is the ignorance of the environmentalists... and the farmers in Nebraska.

## SHARE PRICES HAVE REGAINED HALF OF WHAT THEY'D LOST

on Friday, but futures are well off their highs and the Chinese market, which seems these days to be the sign post for most other markets, closed the day on the downside. In our ETF in Canada we've taken more and more to the sidelines; that is, having been rather bullish of equities previous... and having been most bullish of "ag" related equities primarily.... we've reduced our "market" exposure by buying the VIX and buy reducing long positions were it seemed reasonable and right. We've not reduce our "ag" positions much however, just adjusting positions very, very marginally while remaining as long as we think reasonable in fertilisers primarily.

We do think that the market has seriously over-reacted to the news regarding Mosaic and Cargill, for we seriously doubt that that was a decision motivated by the wish to reduce the Cargill family's exposure to agriculture generally and fertiliser specifically. Rather, this was a decision motivated by the need on the part of Miss Margaret Cargill's bequests to charities that needed cash rather than closely held Cargill stock and as the lawyers devised a means to effect that change this was the end result. Yes, there is now an over-hang of stock on the market, but it can also more readily be taken up by an outside buyer. We wish to be quite clear here: We own Mosaic in our ETF and we intend to remain long of MOS, but we've hedged what we can against the broad market, hoping that MOS is indeed "in play" now that this Cargill transaction has been absorbed and analyzed: .

Dow Indus	up	49	11,872
CanS&P/TSE	down	72	13,259
FTSE	up	28	5,896
CAC	up	53	4,017
DAX	up	18	7,062
NIKKEI	up	70	10,345
HangSeng	up	82	23,763
AusSP/ASX	up	30	4,786
Shanghai	down	19	2,696
Brazil	down	428	69,133
<b>TGL INDEX</b>	<b>up</b>	<b>+0.5%</b>	<b>8,499</b>

**ON THE POLITICAL FRONT,** the more we read about the demise of the regime in Tunisia the more confident we are that this is going to spread to other regimes across north Africa and into the Middle East. As we said in the day after the revolt, this would spread and this will spread by Twitter, Facebook and the internet broadly. The uprising in Tian'anmen Square spread by fax machine, with the Chinese leadership unable to stem the spread of information that swept across the nation. All Beijing could do was call in the Red Army to kill those protesting in the People's Square. The uprising spread quickly, but not quickly enough. There was time for the government to bring the necessary troops into central Beijing to regain control of the situation.

Now, in the era of the internet governments cannot respond quickly enough. The uprising in Tunisia took only two weeks from its very beginning to its end, and in reality most of the activity took place in the last three days before President Ben Ali fled the country. Ghaddafi in Libya; Bouteflika in Algeria, and of course Mubarak of Egypt across Africa's north have to be fearful that the fate that befell their friend in Tunisia may well befall them.

The problem is that in Algeria, Libya and Egypt radical Islam is far stronger and far more capable of taking power than Tunisia. Al Qaeda and the Brotherhood are well organized and prepared to step into the chaotic conditions that always follow hard upon a coup. We of course welcome the overthrow of tyrants but we do fear what may follow.

Turning our attention to Ireland for a moment, two Green Party Cabinet members of Mr. Cowen's coalition government chose to stand down from their positions over the weekend and has put Mr. Cowen's government in even more serious jeopardy than had been thought previous. There is much confusion on our part...and apparently on the part of many in Ireland... regarding the laws governing governance there, but it appears that Mr. Cowens now has lost his ability to remain as the Taoiseach... the proper "Irish" term for Prime Minister. Mr. Cowens himself has resigned as the leader of the Fianna Fail... his party... and technically that means he

cannot remain as the Prime Minister; but again, confusion reigns. All we are certain of is that an election shall have to be called and called soon. The only question is how soon. Some say it can be put off until March; some say it must be held by mid-late February. Some tell us that the budget can be passed first before an election is called; some tell us that that is not true. What we know further then is that confusion reigns and confusions always breeds contempt as we have said for decades.

Finally, tomorrow night President Obama is to give his State of the Union Address. The constitution speaks to this issue... briefly... stating in Article II, section 3 that the President

*shall from time to time give to the Congress information of the state of the union and recommend to their consideration such measures as he shall judge necessary and expedient.*

That is all the Constitution says. It does not say that the President must speak orally to the Congress. It does not state a specific time nor a place. It states simply that he "shall... give to the Congress information of the state of the union." Precedent, not the Constitution, has set the Presidents to speak directly and orally to the Congress in late January and it has been this way largely since 1912. Prior to President Wilson's speech to the Congress in '12, President's "spoke" to the Congress and the nation by written notice. Even after Wilson's decision to speak directly to the Congress, other President's chose not to do so. Coolidge and Harding had their State of the Union messages written, and even modern day President's... Nixon and Carter for example... gave one or two SOTU messages in written form. Since President Carter's last written statement in '81, each speech since has been delivered by the President from one of the Houses of Congress.

In recent weeks, President Obama has moved to the economic and political centre, having been in his own word "shellacked" in the November election. As he's moved center-ward his public support ratings have risen sharply and with the economy on better footing we can expect those support ratings to rise even more sharply in



the days, weeks and months ahead. Much, however, shall depend upon tonight's State of the Union Address. If the President says to Congress that he had pushed too hard for a far too collectivized health care plan and that he is prepared to revise that plan materially; and if the President says that it is obvious that the budget can be, should be and will be cut materially, taking spending back to the levels that prevailed in '08 or even '06 despite the wailing and gnashing of teeth that shall arise on the Left; and if the President says that it is business and not government that creates jobs... then we can expect to see his support ratings surge. But these are big... very, very big... "IF's" and we do not believe that he's of the mindset to make these statements or to adopt these positions. He should, but likely he won't. He will, however, if he wishes to be President again in two years and tomorrow's SOTU speech can be his tipping point.

## COMMENTS ON THE CAPITAL MARKETS

### THERE ARE STUPID THINGS AND THEN THERE ARE REALLY STUPID

**THINGS:** Our antipathy toward ethanol is well known. We know that ethanol gives drivers of most cars demonstrably less mpg than did gasoline of years past when ethanol was merely a dream of America's farmers. We know too that ethanol tends to allow for the creation of moisture in the gas tanks and carburetors of most automobiles, and thus corrodes the auto from within. We know that the "energy" output from ethanol is less than the "energy" input needed to grow corn required. But what we think is the real argument against ethanol is the simple one: it makes absolutely no sense to grow corn to be put into the gas tanks of American car drivers when it should be used to feed cattle, hogs, chickens et al in order to feed a hungry world.

Late last week, the US Congress made a truly stupid decision to increase the ethanol mandate in gasoline here from 10% to 15%, and in the process increasing the usage of corn for ethanol of course by 50%. This is nonsense; this is idiocy; this is the end result of having

Iowa as the first round of presidential politics each four year cycle.

Let's look at the off-take of corn for ethanol use over the course of the past decade. As impossible as it might seem, back in '01, the US used only 600 million bushels of corn for ethanol. That was approximately 6% of the total use of corn that year. It was large, but it was really not material. However, by '06, having risen steadily each year, corn use for ethanol was up to 1.6 billion bushels, and as a percentage of total corn usage, ethanol consumed approximately 14% of the total.

Things were only just warming up at that point, however, for by '08, corn usage for ethanol was up to just a tad over 3.0 billion bushels, and the percentage usage had risen to 24%. In '09, ethanol used 3.7 billion bushels; in '10 ethanol used 4.6 billion and this year... '11... the US is expected to use 4.9 billion bushels of corn. That will be 36% of total corn usage. This is nonsense, but it reality and it is not going to go away no matter how much we and others might argue. American's farmers will not allow ethanol to become a lesser fuel and a smaller demand upon the corn crop. It is 15% mandated now; it will be higher five years hence and higher still ten years hence.

### SO MUCH DEPENDS UPON AN IRISH ELECTION:

William Carlos Williams told us decades ago that "*so much depends upon a red wheelbarrow,*" and so much did. It was as seminal bit of modern American poetry and it remains one of our favourites. We thought of Mr. William's brilliant, threadbare poem this morning for so much now depends upon an Irish election. With the news above of the withdrawal by the Greens from the current coalition Irish government and of Mr. Cowens' decision to stand down from his party's leadership post, there will almost certainly be an election in Ireland by mid-late March and there actually may be one called for February...and so much will depend upon it.

We wonder if there may be a political organisation that shall push not to have Ireland agree to the IMF bank loans forced upon it... to stand down from the government guarantees to bank loans... and to toss the

entire banking crisis back to the centre world stage and put the EUR itself at risk? That's why this election is so important and that's why "so much depends upon" it..

## RECOMMENDATIONS

### 1. Long of Two Units of the Aussie\$ and Two of the C\$/Short of Four Units of the Yen:

Two and three weeks ago we exited most of our long Aussie/short EUR. It was not easy to exit a trade that we'd had in place for nearly 11 months. However, the damage done to the Australian wheat crop and to coal production by the floods is "Old Testament" in nature, and the exports that had been booked shall be either abrogated or entirely stopped due to force majeure. The Aussie/Yen cross is trading 81.95 compared to 81.70 on Friday. The C\$/Yen cross is trading 83.15, compared to 83.05 Friday.

Since then, we've added to our short positions vs. the Yen relative to the Canadian dollar. As we wrote, the Yen/C\$ cross was trading 83.55 and we can "see" this cross trading to 93-94 over the course of the next several months. We have to give this trade some room in which to maneuver, and so our risk shall be to 81. Thus we are risking 2.55 Yen to "make" 10 or more. It is a reasonable risk/reward indeed.

### 2. Long of Three Units of Gold/Short of One Unit of the British Pound Sterling; One of the Yen and One of the EUR:

Two and one half months ago we bought gold in Sterling terms at or near £860 in spot. It is this morning £845.50. This compares to £843.50 Friday.

We are down to a marginal position in gold, and we shall call this our "insurance" position, likely not to be cut any further... with the operative word here being "likely."

**3. Long of One Unit of March KC Wheat:** Five weeks ago, we became long of the grain markets, buying KC hard red winter wheat at the time and three weeks ago we added to it. We bought soybeans shortly thereafter and until Thursday of last week we were comfortable, but then we cut our wheat in half and exited our "bean" position entirely. Clearly we need to re-establish our wheat position and will do so on any weakness later this week.

**4. Short of One Unit of the EUR:** Given our comments here Jan. 6<sup>th</sup>, we sold the EUR. We added a second unit several days later, giving us an average of 1.3050. On Friday, behind by three full EURS, we cut this trade by half. Our duty is to be alive to fight another day and a severe wound can heal if treated swiftly enough. We may soon cut the rest of this position.

**5. Long of One Half Unit of Nat-gas:** As noted at length earlier this week, we've found ourselves becoming bullish of nat-gas, but rather than owning nat-gas futures we shall wish to own Nat-gas trusts and or equities focuses upon nat-gas specifically. We need to have some very small exposure to the market beginning then, but we'd reserved the right to buy more on a period of weakness... one of the very rare times we may add to a position that shows a small loss.

### 6. Long of Two Units of the Swiss Franc/short of Two Units of the British Pound Sterling:

We acted Wednesday, Jan. 19<sup>th</sup> and we gave the trade 3% to move against us initially... and as noted last Thursday...Jan. 20<sup>th</sup>... we added a second unit to the trade upon receipt of this commentary. Our target is 1.3900-1.4000 and our new stop is 1.5650, requiring the cross to trade above and to remain

above that level for an hour to prove its "merit."

*The following is not a recommendation, a solicitation or an offer to sell the securities and reflects publicly available pricing information provided for informational purposes only. The Gartman Letter L.C. serves as a sub adviser to the products mentioned below. Investors in the CIBC Gartman Global Allocation Deposit Notes should go to:*

<https://cibccpn.com/ScreensCA/CANProductUnderlyings.aspx?ProductID=221&NumFixings=3> Existing investors in HAG should go to:

[http://jovian.transmissionmedia.ca/fundprofile\\_hap.aspx?f=HAG&c=81](http://jovian.transmissionmedia.ca/fundprofile_hap.aspx?f=HAG&c=81)

The following positions are "indications" only of what we hold in our ETF in Canada, the Horizon's AlphaPro Gartman Fund, at the end of the previous trading day. We reserve the right to change our opinions at a moment's notice and we reserve the right to take positions opposite of what maybe in our "Notes" and ETF from time to time as market conditions warrant.

**Long:** We own "stuff" and the movers of "stuff." We have positions in an iron ore miner, a palladium/platinum miner, and a railroad company. We also own an "Asian" short term government bond fund, the C\$, the A\$, Swiss Francs, gold, an international oil and gas company, a crude oil trust, and a North American midstream energy company. Lastly, we own three agriculture-related companies as well as an ETF that tracks agricultural commodity prices generally.

**Short:** We are short the Euro, the British Pound, and the Yen. We own a double inverse broad equity index ETF and a leveraged ETF that tracks the VIX Index to hedge the positions mentioned above and are short a global investment bank.

The CIBC Gartman Global Allocation Notes portfolio for January is as follows:

**Long:** 15% Canadian Dollars; 5% Australian Dollars; 10% Gold; 5% Silver; 10% Wheat; 5% Corn; 5% Soybeans; 10% Sugar; 10% Crude Oil

**Short:** 10% Euros; 10% British Pound Sterling; 5% Japanese Yen.

*Finally, due to a computer problem back in our home offices we cannot update our NAVs for our ETF and/or our guaranteed notes in Canada this morning. We hope to have that problem fixed by tomorrow morning upon our return to our offices.*

**Good luck and good trading, Dennis Gartman**

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## Appendix F: Example of a Henry Lui weekly market outlook

Hello everyone:



**THE GARTMAN LETTER L.C.**

**Monday, January 24th, 2011**

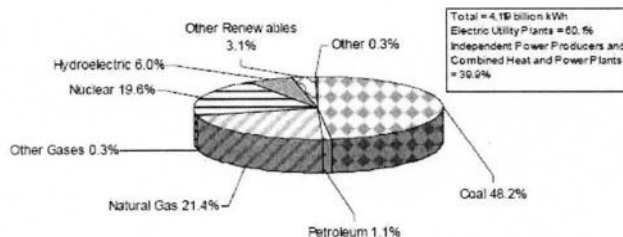
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### OVERNIGHT NEWS:

## THE US DOLLAR CONTINUES GENERALLY TO WEAKEN

with the world focusing its attention of course upon the EUR/dollar rate primarily, and indeed the dollar has weakened and has weakened quite sharply in the course of the past five or six trading sessions. It was only the first week of the



year when the EUR had traded down to 1.2900 and the news out of Europe was of continuing political upheaval within the Union and of worse-than-expected economic data. Since, the view of all things European has turned on the proverbial dime, and now it is as if all things political and all things economic in Europe have been and shall be bright and shiny whilst all things North American are dulled and disdainful. The psychology of the foreign exchange market is schizophrenic always and everywhere, and it is especially so at the turns of the year.

### WE'RE IN OHIO THIS

**MORNING:** Mr. Gartman is in Cuyahoga Falls, Ohio this morning, taking care of family business and then attending the University of Akron Foundation investment committee meeting. TGL is in its regular format at its regular time, but Mr. Gartman will not be available by telephone, although he will be answering e-mails when possible. He is turning this evening.

### ELECTRICITY GENERATION IN THE US BY FUEL

**SOURCE:** This fascinating chart details the fuels used in the US to generate electricity: Coal trumps'em all, followed by natural gas, followed by nuclear.

The week will focus on two things: the President's State of the Union Address tomorrow evening and the FOMC meeting that begins tomorrow afternoon and

ends Wednesday afternoon. Let's take the latter concern first, noting that this is the first meeting of the new year of course and that means a shifting of the rotation of the regional federal reserve bank Presidents to the position of "voting member." Out are Cleveland's President; Boston's President; St. Louis' President and the President of the Kansas City Federal Reserve; "in" are the Presidents from Chicago; Philadelphia; Dallas and Minneapolis. The "In's" are Mr. Charles Evans from Chicago; Mr. Charles Plosser from Philadelphia; Mr. Richard Fisher from Dallas and Mr. Narayana Kocherlakota from Minneapolis.

### MARCH KC HARD RED WINTER WHEAT: A Bull

*In Full Regalia: This is what a bull market looks like when the fundamentals and the technicals are in full gear and well meshed. We need to buy weakness back toward or even merely near this trend line.*

Much debate within the economic world has of late centred upon what we all expect these new rotational members of the FOMC to do and simply put we expect the composition of the FOMC to have changed very little. We

can reasonably expect Chicago and Boston to vote with

As long as we don't get a strong sentiment change in the Euro, i.e. debt crisis is over, the possibility for this trade to work out should be pretty high in my opinion.

## EURUSD

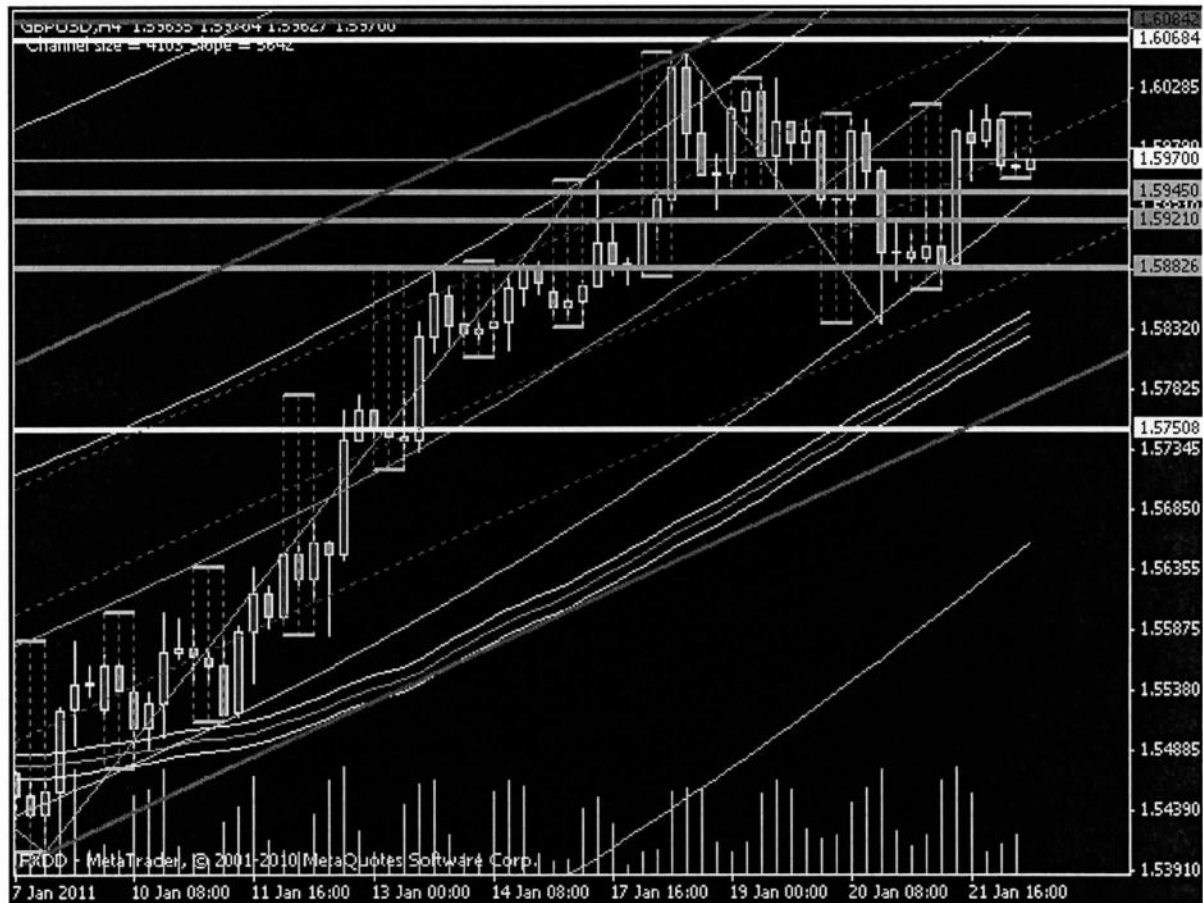


Looking at the Sterling and its fundamental outlook, I have to say that the general sentiment is pretty positive for the currency. With a persistent high inflationary pressure and strong release figures in the past quarterly GDPs, most analysts are expecting to see a stronger and sooner recovery in UK when compared with the rest of Europe (in general). However, the key for Sterling will rest on the Prelim GDP release scheduled for this week. If we do get a strong release, we could very well see GBPUSD testing the 1.6300 level, and at the breach of which, 1.6500. If we get a weaker release, I believe market could send GBPUSD down at the 1.5750 level, but the real support for the pair lies around the 1.5500.

Therefore, I would expect to see some stalling (ranged trading) for the pair as the 1.6000 figure is a psychological resistance. Traders will probably not be willing to commit to a direction until after the GDP release; therefore I'll remain neutral until then. Of course, if we do get a mostly

inline release, market will probably look at the general trend of the Euro to determine the direction for GBP.

## GBPUSD



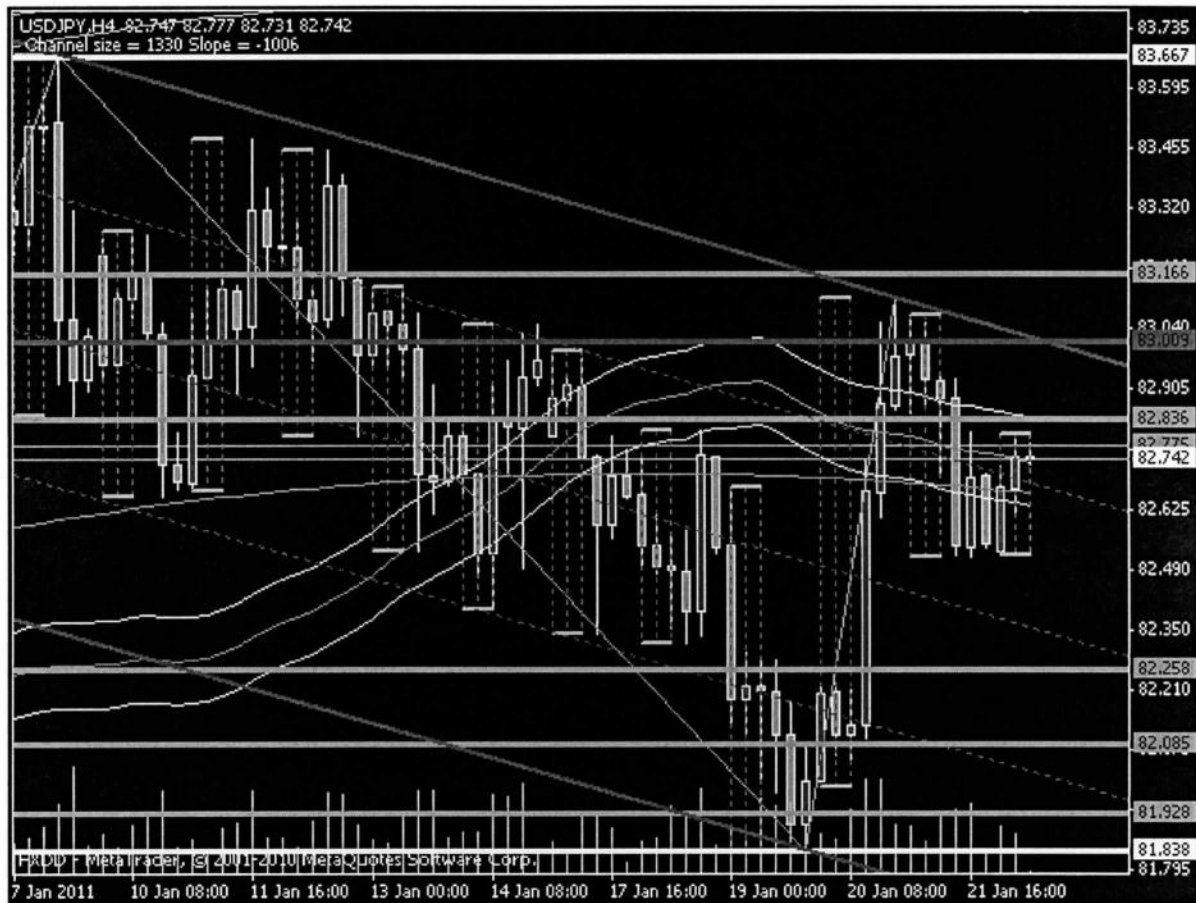
JPY has remained pretty much directionless in my opinion, merely just reacting to the general market sentiment for the past few weeks. I believe that the lower range of the pair, between 81.75 ~ 83.00 is layers with BUY orders support the pair from collapsing again, which makes this pair a very good optional short-term trade to go LONG whenever market pushes the pair down to the 82.00 level.

The overall trend for the Japanese Yen in the long term is widely expected to weaken, however with the uncertainty in the Euro and the less than optimal economic condition in the U.S., JPY is still considered as a strong alternative.

However, I believe as market starts to recover, which is just a matter of time, JPY will likely to fall back to its role as carry currency, and USDJPY should appreciate rapidly. With this week's

FOMC Statement and Advanced GDP release out of US, we could see some strong moves in the pair, if we were to get a huge surprise.

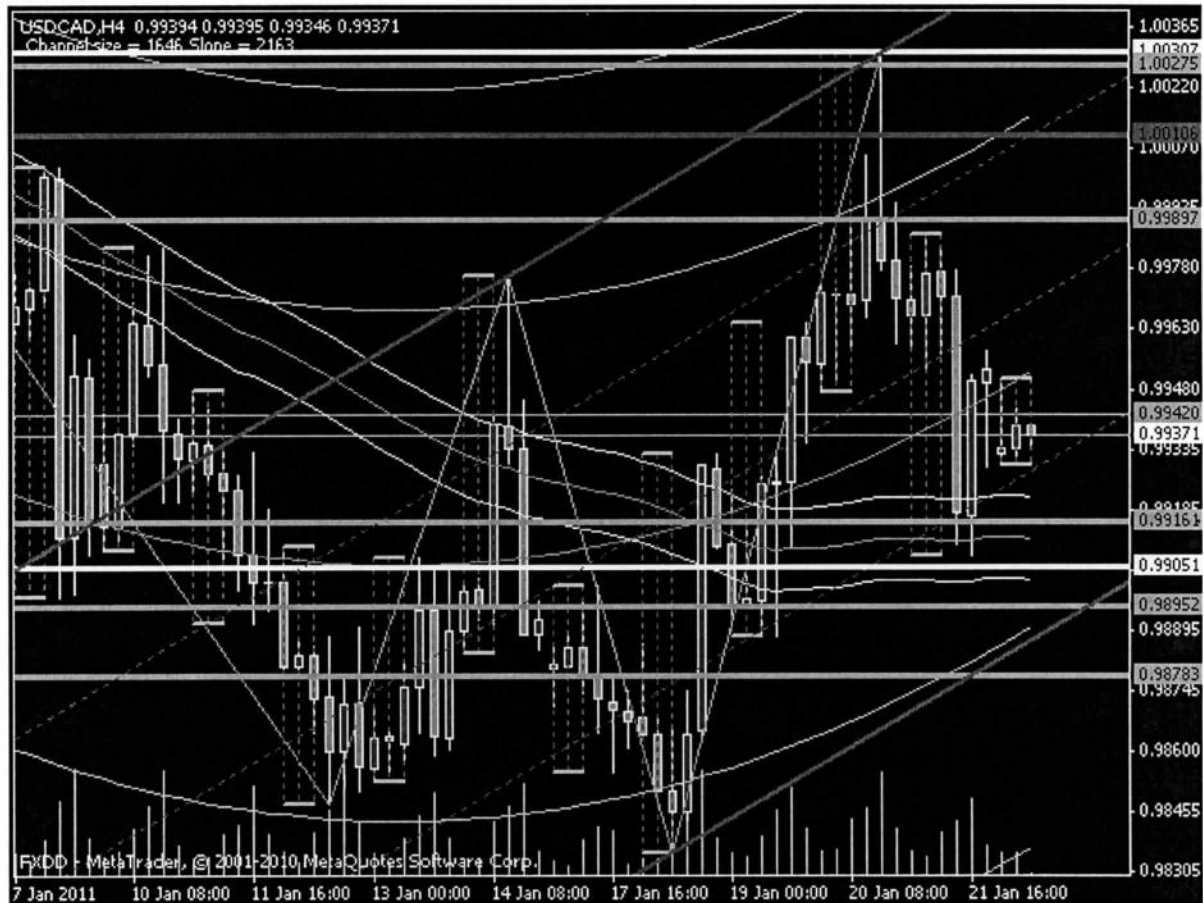
### USDJPY



USDCAD spend most of the last week around 0.9900 ~ 1.0050 level, after the much anticipated BOC Interest Decision. With CAD benefiting from the general commodity gains, CAD is being well supported. However, with USDCAD trading above the parity level again last week, I do see some consolidation for the pair or at the very least, the potential gains of CAD against USD is to be limited. As a matter of fact, I believe we will probably see 1.0200 next instead of 0.9800.

Of course the GDP and FOMC release out of U.S. will play a big part for the general direction of USD, which will also affect the USDCAD pair. With USDCAD sitting at the support levels around 0.9900, a strong US release should drive the pair above 1.0100 in just one session, as when this pair moves, it moves violently.

## USDCAD



USDCHF is once again trading towards the lower end of the range, and I'd definitely recommend a BUY if the pair trades around or below the 0.9500 level, which has been a strong psychological and technical level of the past few months. Unless EURUSD were to breach the 1.3850 level, I'd expect to see USDCHF to retrace slowly from the lows and possibly go above the 0.9700 ~ 0.9900 in a short term.

CHF is considered as a safe-haven and neutral currency, which is very sensitive to the situation in Europe. If EURUSD were to go above 1.3850 levels, it probably means that USD is being heavily sold off, and that could temporarily push USDCHF down to the low end of the range, which is just around 0.9300...

However, with EURUSD continue to advance; assuming that the situation in the U.S. also improves, CHF will definitely be sold off against both currencies, thus helping the pair to make a strong comeback regardless... In other words, I don't expect to see USDCHF remain below

parity for a very long time... It is confusing times like this, when most traders have no confidence in major currencies, CHF gets strong demands.



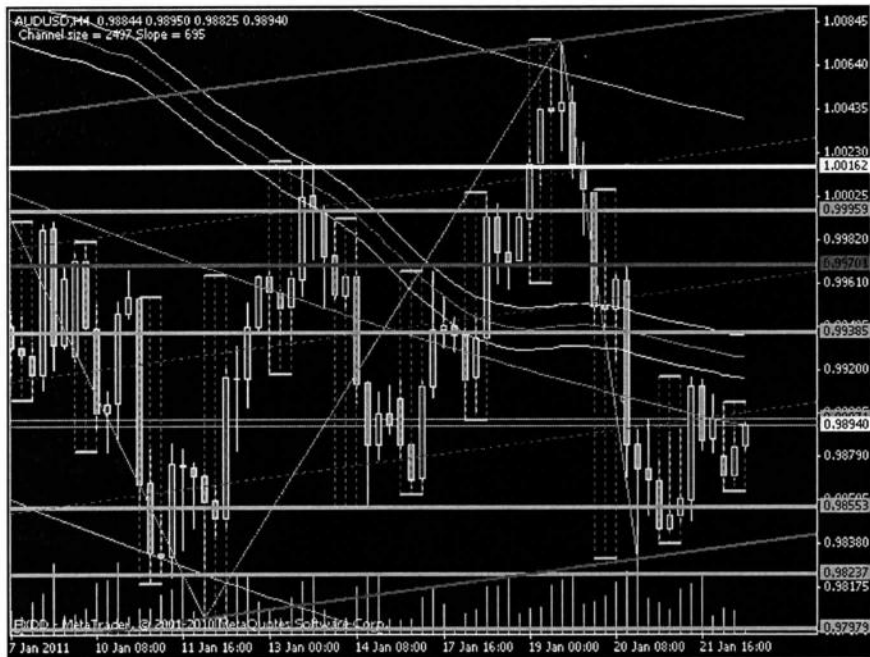
**AUDUSD and NZDUSD** are both benefiting from strong commodity rallies the week before, which resulted in consolidations the following week.

NZD took a dive as the CPI release disappointed expectation, as most traders were expecting a much better number... However, because of the inline with expectation release, a dose of reality was injected in the market as traders were thinking "What The Heck Are We Doing..." going LONG on NZDUSD, pushing the pair towards the 0.7800 level.

Looking ahead this week, I'd expect to see some consolidation in both pairs, perhaps more directional bias AFTER U.S. news on Friday.

Overall, I am still bearish on both pairs, perhaps more on the AUDUSD for the time being as traders are still pretty positive on NZDUSD, but this could change in a flash when funds flow out of NZD into AUD. Just keep your eyes on the AUDNZD pair.





SELL AUDUSD close to parity (1.0000)



SELL NZDUSD between 0.7650 ~ 0.7750

\*\*\*

# Weekly Outlook January 24 ~ 28, 2011

Date	Time	Currency		Forecast	Previous
Sun Jan 23	7:30pm	AUD	PPI q/q	0.5%	1.3%
Mon Jan 24	▶3:00am	EUR	French Flash Manufacturing PMI	56.8	57.2 ↘
	▶3:00am	EUR	French Flash Services PMI	55.2	54.9 ↘
	3:30am	EUR	German Flash Manufacturing PMI	61.1	60.7 ↘
	3:30am	EUR	German Flash Services PMI	59.2	59.2 ↘
	4:00am	EUR	Flash Manufacturing PMI	57.1	57.1 ↘
	4:00am	EUR	Flash Services PMI	54.2	54.2 ↘
	5:00am	EUR	Industrial New Orders m/m	2.3%	1.4%
	1:00pm	GBP	MPC Member Sentence Speaks		
	Tentative	USD	Treasury Currency Report		
	6:00pm	AUD	CB Leading Index m/m		0.6%
	7:30pm	AUD	CPI q/q	0.8%	0.7%
	7:30pm	AUD	Trimmed Mean CPI q/q	0.8%	0.6%
	Tentative	JPY	Monetary Policy Statement		
	Tentative	JPY	Overnight Call Rate	<0.10%	<0.10%
	Tue Jan 25	Tentative	JPY	BOJ Press Conference	
2:00am		CHF	UBS Consumption Indicator		1.63
2:00am		EUR	GfK German Consumer Climate	5.5	5.4
2:45am		EUR	French Consumer Spending m/m	0.4%	2.8%
4:30am		GBP	Prelim GDP q/q	0.5%	0.7% ↘
4:30am		GBP	Public Sector Net Borrowing	18.3B	22.8B
7:00am		CAD	Core CPI m/m	-0.1%	0.0%
7:00am		CAD	CPI m/m	0.2%	0.1%
9:00am		USD	S&P/CS Composite-20 HPI y/y	-1.4%	-0.8%
10:00am		USD	CB Consumer Confidence	54.5	52.5
2:40pm	GBP	BOE Gov King Speaks			
26th-30th	AUD	NAB Quarterly Business Confidence		9	
Wed Jan 26	12:00am	JPY	BOJ Monthly Report		
	All Day	ALL	WEF Annual Meetings		
	4:30am	GBP	MPC Meeting Minutes	1-0-8	1-0-8
	Tentative	GBP	BBA Mortgage Approvals	29.9K	30.0K
	10:00am	USD	New Home Sales	302K	290K
	10:30am	USD	Crude Oil Inventories		2.6M
	2:15pm	USD	FOMC Statement		
	2:15pm	USD	Federal Funds Rate	<0.25%	<0.25%
	3:00pm	NZD	Official Cash Rate	3.00%	3.00%
	3:00pm	NZD	RBNZ Rate Statement		

	6:30pm	AUD	MI Leading Index m/m		0.3%
	6:50pm	JPY	Trade Balance	0.53T	0.43T
Thu Jan 27	27th-31st	GBP	Nationwide HPI m/m	-0.2%	0.4%
	All Day	EUR	German Prelim CPI m/m	-0.3%	1.0%
	All Day	ALL	WEF Annual Meetings		
	6:00am	GBP	CBI Realized Sales	39	56
	8:30am	USD	Core Durable Goods Orders m/m	0.9%	3.6% ↘
	8:30am	USD	Unemployment Claims	409K	404K
	8:30am	USD	Durable Goods Orders m/m	1.6%	-0.3% ↘
	10:00am	USD	Pending Home Sales m/m	0.8%	3.5%
	6:30pm	JPY	Household Spending y/y	-0.5%	-0.4%
	6:30pm	JPY	Tokyo Core CPI y/y	-0.3%	-0.4%
	6:50pm	JPY	Monetary Policy Meeting Minutes		
	6:50pm	JPY	Retail Sales y/y	0.6%	1.5% ↘
	Fri Jan 28	All Day	ALL	WEF Annual Meetings	
4:00am		EUR	M3 Money Supply y/y	2.1%	1.9%
5:30am		CHF	KOF Economic Barometer	2.12	2.10
8:30am		USD	Advance GDP q/q	3.5%	2.6% ↘
8:30am		USD	Advance GDP Price Index q/q	1.7%	2.1% ↘
8:30am		USD	Employment Cost Index q/q	0.5%	0.4%
9:55am		USD	Revised UoM Consumer Sentiment	73.1	72.7

### Monday January 24, 2011

**7:30pm AU CPI q/q:** We'll be trading this release today using **Retracement Trade** if we do not get a huge deviation. If we do get a 0.4% deviation, then a **Spike Trading** is justified.

### Tuesday January 25, 2011

**4:30am UK Prelim GDP q/q:** I'll be looking for a possible **Spike Trading** for this release as this is likely to be a very high impact release.

### Wednesday January 26, 2011

**4:30am UK MPC Minutes:** We'll be looking for a **Retracement Trade** for this release. With events such as Meeting Minutes, market usually needs some time to digest.

**10:00am US New Home Sales:** We'll be looking for a **Retracement Trade** from this release. If we do not get a tradable figure, it's best to stay out as the market is packed with news events later on.

**2:15pm FOMC Statement:** We'll stay on the sideline and wait for the market to determine a direction first before we jump in. If you are not part of the live trade room, please stay out of the market or do your own research. I'll be putting out an analysis prior to this release.

**3:00pm RBNZ Interest Rate:** This would probably be a no-event. But in very unlikely case that RBNZ hikes rate, we'll jump in immediately in a **Spike Trade**.

**Thursday January 27, 2011**

**No Trade (However, we do have Unemployment Claim, Durable Goods, and Pending Home Sales from U.S., but these releases aren't tradable in my book, but do keep an eye out during the release time)**

**Friday January 28, 2011**

**8:30am US Adv. GDP q/q:** This is the 4<sup>th</sup> Quarter of 2010 GDP release. We'll probably see market start to develop a trend after this release for the next few weeks IF we get a strong deviation. Therefore, we'll definitely use our **Retracement Trade** method for this release.

Thanks,

Henry Liu