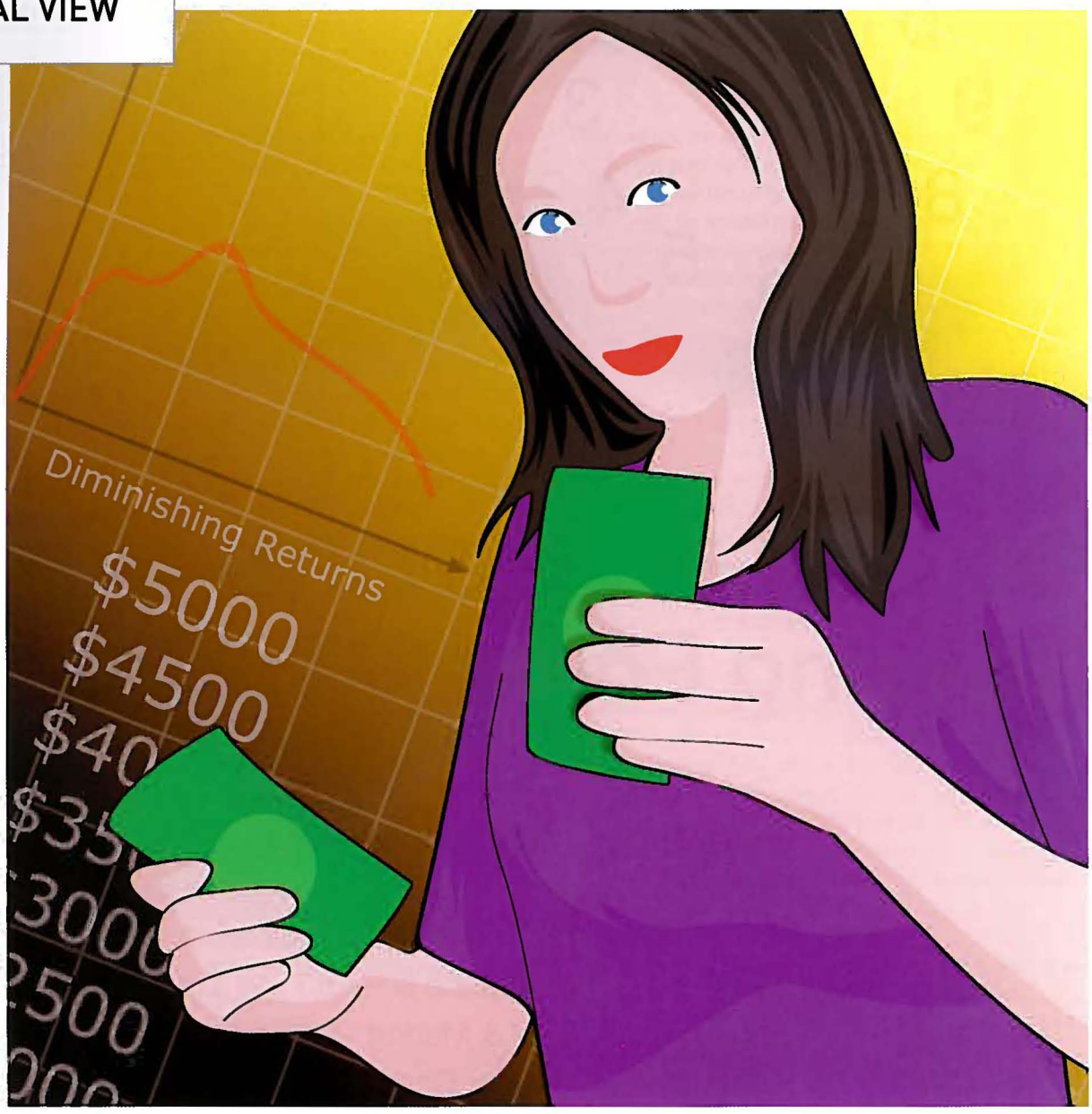


Best and Worst Currencies in 2011

For the 4th year running, short-term volatility in the Forex markets remained high, creating numerous opportunities to generate profitable trades. Marc Spaelti looks at winners, losers, the most stable and the volatility of major currency pairs in 2011.

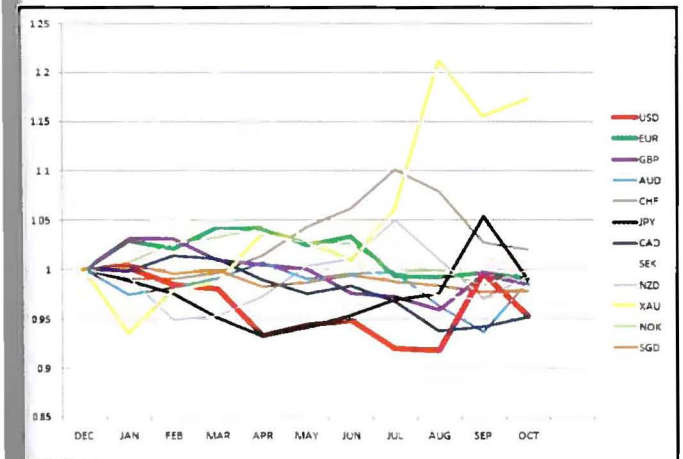
As the end of 2011 is rapidly approaching, we take a look at the market movements of the past few months. For the 4th year running, Forex traders will agree that short-term volatility remained very high, creating numerous opportunities to generate profitable trades. EUR/USD, the most widely traded pair has seen 9 movements measuring 500 pips or more this year. It also remained locked in a wide range between 1.30 and 1.40, making it easy for any medium-term players to do well.

And the winner is –

Gold. Besides the fact that gold remains a commodity and does not represent legal tender in any particular country, it has been trading and handled very similarly to regular Forex spot business. Widely used in electronic trading, liquid enough for institutional business and highly popular with retail Forex traders, we have decided to add gold to the 11 most widely traded Forex spot currencies.

Since January 1, gold has risen more than 17% against our basket of currencies. Considering that the metal initially shed 5% in January and peaked above 20% at the end of August, a single, perfectly timed trade using a moderate leverage of four would have been sufficient to double ones equity. XAU/USD remains by far the most actively traded gold cross. In fact, most retail clients completely ignore that gold can be traded against any other currency.

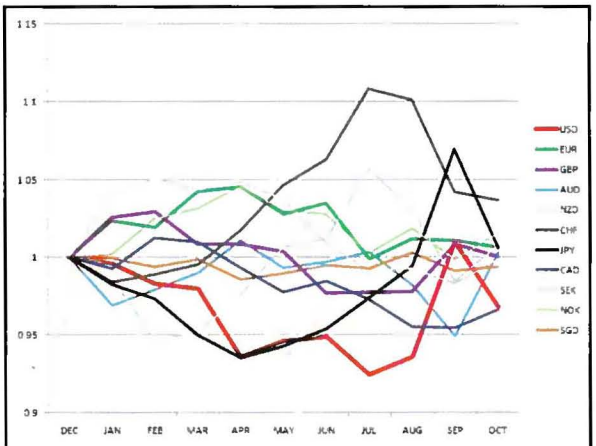
Especially non-U.S. clients should consider what it means to hold XAU/USD positions when revaluing a portfolio in their domestic currency. For example, XAU/CHF has only started to significantly rise since August. From January throughout July, XAU/CHF remained close to its opening price of 1325.



GRAPH 1

Graph 1 shows an overview of the relative value changes of each of the 12 main currencies against each other: USD, EUR, JPY, GBP, CHF, CAD, AUD, NZD, NOK, SEK, SGD and XAU. The price levels of all twelve currencies were indexed at 1 using the closing prices of December 31, 2010. Monthly closing levels were used to calculate an average value for each currency.

Gold's massive push in August causes it to stick out. Despite a large correction in September, it remains at a high value, which it is unlikely to shed in what remains of this year. To be fair, we acknowledge that gold can be extremely volatile and that repeating this exercise over a span of 10 or even 20-years would bring this outstanding performance in perspective. Compared with gold, all other currency movements seem muted, that is why gold was removed in Graph 2.



GRAPH 2

CHF has been the strongest of the world's currencies in 2011. From the end of end January to July, CHF gained more than 12%. In fact on August 9 and shortly before the Swiss National Bank's first strong intervention, the Swiss franc reached a peak above 1.15 on our index. The movement in favor of CHF has been ongoing since 2008. In the aftermath of the initial financial crisis, investors were quick to renew with the Swiss franc's tradition as a save heaven currency, accumulating massive long positions in the process.

With the U.S. in recession, a string of European countries in distress and commodity currencies at the mercy of slowing world consumption, CHF seemed to be the only valuable alternative to place excess cash. After numerous half hearted attempts

in 2010 and early 2011 and with the backing of Swiss politicians of all parties, the Swiss National Bank finally succeeded in imposing a floor to EUR/CHF in early September. Two months have passed and it seems that the Swiss central bank's efforts have been successful. In view that the CHF remains overvalued by more than 30% in the long-term, their action has been accepted by other central banks and we can expect that the floor of 1.20 in EUR/CHF will be defended vigorously if needed.

And the loser is –

The U.S. and Canadian dollars trail our graph, losing nearly 4% since the beginning of 2011.

The USD came under strong pressure early in the year. Growing deficits and the inability to effectively pass budget increases through Congress undermined the dollar. The budget issues clearly illustrated the near impossibility for the current U.S. government to implement any measures that may try to spur economic growth.

Heading into an election year, we doubt very much that this will change in 2012. It is unfortunate, but it seems that the two political clans – or at least one of them – is more concerned with stabbing the other in the back than finding any constructive solutions to lead the economy out of its misery. Still, the U.S. dollar did manage a comeback in September, ending the month slightly above 1. This came not because of any particular USD strength but the combination of falling commodity currency values and the Swiss National Bank intervention.

The CAD suffered mainly from decreasing consumption as global economic views continue to point to a double dip recession in 2012 and 2013. In addition, its proximity to the United States as main trading partner caused some spillover from the U.S. economic slowdown, accentuating the general commodity currency weakness in 2011.

The most stable of the lot –

SGD, freely exchangeable in the Forex spot market, Singapore's MAS loosely controls its currency against a secret basket of currencies. Most interesting in looking at the Singapore dollar's relative movements in 2011 is the surprisingly low impact that the JPY and USD seem to have. How else can you explain a falling SGD while both JPY and USD massively gained in September? The MAS basket surely contains some currencies that are not present in our index, such as the CNY, MYR and IDR, however, it seems that a rather large portion is attributed to AUD and especially NZD.

Large volatility in most pairs –

Most widely traded currency pairs have seen good volatility while remaining in wide ranges this year. Unlike the years from 2003 to 2007 when carry trades dictated long-term directional trades, the same price movements were repeated multiple times, giving anybody a fair chance to eventually turn any trade at a profit. Overall, it can be stated that medium-term strategies running low risk exposure have fared best in this environment.

A look at weekly volatilities reveals that most commonly traded currency pairs enjoyed good intra-week ranges. For example, EUR/USD has seen a weekly average price discrepancy between its high and low of 2.6% or close to 200 pips. Once again, gold (XAU/USD) has been the most volatile with a weekly average of 4.1%, but its movements were a bit less evenly spread out as there has been a total of 7 trading weeks – or about 15% of cases – where the difference from high to low was in excess of 8%.

Many Japanese yen crosses including EUR/JPY, AUD/JPY, CHF/JPY and NZD/JPY averaged weekly price movements of more than 3%. These occurred regularly, giving any trader ample opportunity to catch a good move and try again the next week and the week after that.

Traders looking for opportunities were not at all limited to the yen crosses. Weekly averages were 2.6% for EUR/USD as mentioned, AUD/USD averaged just over 3% and USD/CHF even more with 3.4%, mostly due to two extreme weeks in early August and September when the Swiss National Bank intervened to stop the CHF from rising, causing weekly movements of 10% and 12% respectively.

The list can be increased with USD/CAD, which averaged 2.1% of price movement per week and Cable nearly 2%, which represents a good weekly range of some 300 pips. Returning to non-USD crosses, the EUR/AUD with 2.3% and EUR/NZD with 2.8% fared best.

Not only was 2011 marked by many large price movements in just about any liquid currency pair that can be

traded on a 24-hour basis and with any broker, the following selection of weekly charts illustrate, that it was difficult to find a wrong entry point. In other words, no matter at which point any trade was opened, sooner or later this trade could have been closed at a profit. With interest rates in a range between 0% and 1% in USD, EUR, CHF, JPY, GBP, CAD and SGD, traders were able to hold positions for weeks or months at negligible carry costs.



GRAPH 3 EUR/USD

More than 60% of trading volume done in retail Forex is concentrated in EUR/USD. This is unfortunate as it increases the risk of short-term spikes especially around news-times and because there are just as many trading opportunities in other currency pairs. Since it is so very popular, here is a look at the weekly chart of 2011. The year started with a strong 3-month ride up exceeding 1200 pips from 1.36 to 1.48 and a series of 400-pip to 700-pip movements in a consolidation phase, which ended in July. Another 1300-pip movement down allowed anybody to cover short positions that may have been entered in January/February before another 900-pip up/down was seen since mid September.



GRAPH 4 AUD/USD

AUD/USD belongs to the tier-two pairs. Still very liquid, trades very actively and as can be seen from the graph, it has more or less followed the overall movement of EUR/USD with one large rise in spring, a consolidation phase where each major movement counted more than 400 pips, followed by a dip beneath the year's low from January and a subsequent 1000-pip move up (and down?) Simply to illustrate that one may trade something other than EUR/USD.

It is to note that the AUD is the only major currency with high interest rates – a long AUD position can be rated as carry trade.



GRAPH 5 NZD/JPY

Here is an example of a less popular pair to represent the volatility of the JPY-crosses this year. It is similar to the USD charts, meaning that just about any trade (long or short) done in January could have been closed at a profit sometimes later on. While price movements in pips are smaller with 200-pip moves a regular occurrence, one shall not forget that 200 pips in NZD/JPY is similar to 400 pips in EUR/USD.



GRAPH 6 EUR/AUD

Another of the more exotic pairs, but one with very large price swings and not too correlated to the USD. EUR/AUD has had a total of 6 movements exceeding 1000 pips! A pip in EUR/AUD is very similar to a pip in EUR/USD, so any medium term player that has not yet discovered this cross, may want to start to look for trading opportunities in this pair.

Once again, the absence of any directional trend is appar-

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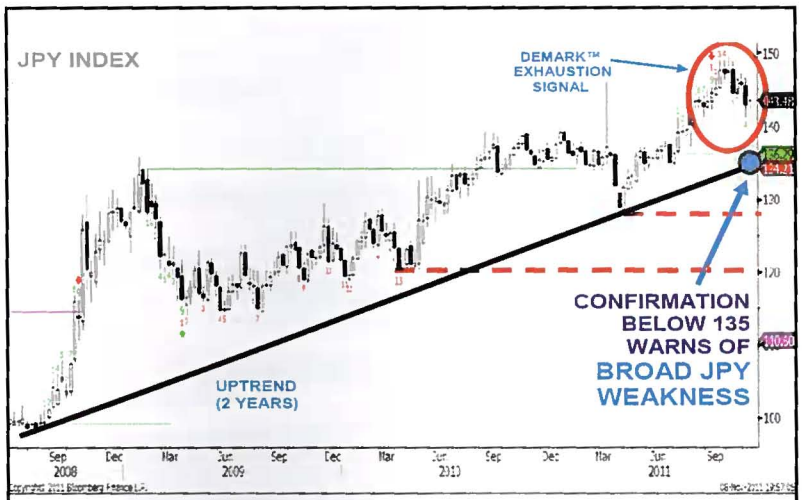


FIGURE 11: Daily Chart of Japanese yen Index. (Bloomberg Finance LP)

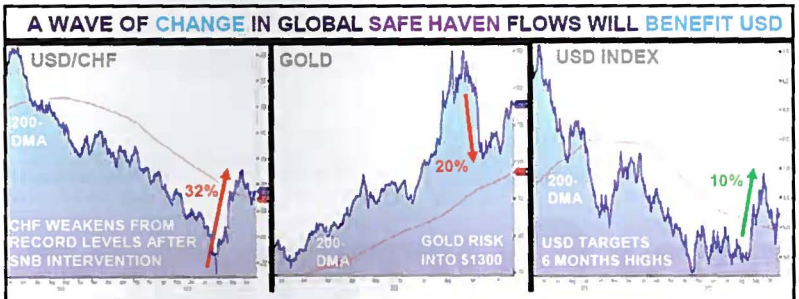


FIGURE 12: Daily Chart of USD/CHF, Gold and the USD Index. (Bloomberg Finance LP)

broad Japanese yen weakness to mark another wave of change in global safe-haven flows, which has traditionally been attracted to the yen and previously Swiss franc and gold. In a relatively weak beauty contest, the U.S. dollar, which is at a polar opposite technical set up (oversold levels), will gain from this domino effect, as capital searches for a new safe home.

• *However, in the short-term, USD/JPY will remain a "house of pain" trade, marked by two-way volatility. Astute investors and traders can use additional methods to manage their risk/reward exposure through option strategies. Watch strategic upside price levels on USD/JPY ahead of an important cycle inflection points into November/December 2011 – $80.00-60, then $83.30 and $85.50 with upside scope into $94.00. In relative terms, high-yielding currencies such as TRY, BRL, ZAR, are set to gain most from a massive unwind of the popular carry trade.* **FJ**

– Ron William, CMT, MSTA is the Technical Strategist in MIG Bank.

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ent and unless one has opened a long position at 1.43 or a short at 1.30, one could not have gone wrong with any trade.



GRAPH 7 USD/CHF

Without exception, USD/CHF is, besides gold, the only instrument that has held a long-term trend in 2011. Down from January to mid-July, the trend suddenly reversed with the help of the Swiss National Bank intervention. It must be added that USD/CHF near 0.70 was indeed an exaggeration as an increasing number of investors joined the wave, buying CHF for an easy profit. Yes, the Swiss National Bank did massively intervene on two occasions, but as many traders and investors continue to hold long CHF positions, unwinding those positions has lead to a prolonged rise in USD/CHF. **FJ**

– Marc Spaelti, Risk Manager at Dukascopy (Suisse) SA has 18 years of experience in the Forex exchange market. Working for various banks and brokers in New York, Singapore and Switzerland, he has covered all aspects of the market: trading Interbank Forex spot, running proprietary option positions and covering institutional clients through advisory desks. Marc regularly contributes articles for various publications.