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Personal disclaimer

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I do accept custom programming orders to help traders automate and test their ideas. I am also available to conduct custom market research, including programming any tools necessary. Anyone interested is welcome to contact me through information provided in this newsletter.

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Introduction

List of abbreviations

Any currency can be abbreviated with its first letter:

- U – USD, US Dollar
- E – EUR, Euro
- G – GBP, British Pound
- C – CAD, Canadian Dollar
- H – CHF, Swiss Franc, (because C is already used for Canadian Dollar)
- A – AUD, Australian Dollar
- N – NZD, New Zealand Dollar
- J – JPY, Japanese Yen
- M – MXN, Mexican Peso

Similarly any trading pair can be shortened to 2 letters. Examples:

- EURUSD – EU
- USDMXN – UM
- CHFJPY – HJ

Support and Resistance levels:

- S – Support
- R – Resistance
- SR – Support and Resistance (when referred to in general)
- TL – Trend Line
- Ch – Channel
- PP – Pivot Point

Time frames

- TF – Time Frame of the chart
- MN – Monthly
- W1 – Weekly
- D1 – Daily
- H4 – 4 hours
- H1 – 1 hour

Commitment of Traders

- COT – Commitment of Traders
- NC – Non-Commercial

Unrealistic expectations

As I mentioned many times before, it is my opinion that your expectations about the market is one of the most important aspects in defining you as a consistently profitable trader. Market is unlike any day job in that you do not have a clear certainty in your expectations, like the amount of your paycheck, possible promotions, vacations, health plan, etc. When you trade for living all these variables have to be defined by you. Alas, not all of them can be clearly defined at all.

In the previous article we discussed how you can build your expectations about the amount of work you have to do, how often you have to analyze the market, for how long you are going to hold the trades, etc. Today I would like to concentrate on another very important aspect, that of your profit expectations.

I think that many traders start with completely unrealistic expectations, which leads to a lot of frustration and emotional pain as they cannot get these fulfilled. When you see ads on TV with a truck driver owning his private island, implying that he bought it from the profits made in the market in his free time, it is not difficult to understand why so many traders are greatly misled.

Profit generation

First of all, let's take a look at how the profit is generated on the market. At first sight it seems an obvious question - the profit is generated by the trades we close and open. I would like to argue that it is not as simple as that.

In my opinion it is much more beneficial to view the direct outcome of the trades as the return ratio between the risk in these trades and the reward they return in terms of price movement that was taken. In other words, if the trade returned 100 pips and we risked to be stopped out at -50, this trade generated the return ratio of 2 (100/50). I find such definition much more helpful because it emphasizes that our profit is always tied to our risk, to the potential loss we can have on that trade.

I keep emphasizing that on the market the goal number #1 is survival, i.e. account preservation. We have to play good defense before we can start applying offense.

With most investing even if you put all your money in just one company you are risking blowing up the whole account only if the company's stock ends up trading completely worthless and there is no one who will take it from you even for free. When you distribute your money between 10 different companies in different sectors you chances of blowing up 100% of your original stake are getting pretty low. With options, futures or on Forex everyone is so used to huge leverage that they cannot even imagine trading without it.

When you trade on Forex, you normally get anywhere from 1:50 to 1:100 leverage. The leverage basically means that you can invest 50 or 100 times more money than you own. However, when you invest 100 times more than you own, the account will be wiped out with only 1% move against you instead of 100% when you trade with no leverage. At the same time you can double your money 100 times faster when the price goes in your favor.

Let's take a look at a reasonably conservative example. Let's say that we want to limit our potential losses to no more than 10% a month calculated from the initial capital at the start of the month. Given 20 trading days a month, we will have 0.5% risk available each day. To make sure we don't lose all the money we already made, let's say that we never open more than 0.5% worth of new positions on any given day.

Let's say we lose 10% a month for the whole year and we started with $10 000. What is the size of our capital by the end of the year? No, we are not in debt of $2000 because we lost 120%. Our capital is still ~$2541. Because each month we recalculated our risks, when we lost the first 10% ($1000), the next month we only had $9000*10% = $900 available to risk. Essentially, it is not possible to blow up the whole account when using even such a simple money management technique.

However, let's also consider how long it will take us to rebuild the account back to $10 000, giving the same trading rules and starting after 12 months of losses, i.e. at $2500. After 12 months stably making 10% and compounding our profits at the end of

each month we will be at $7846. It will take another two and a half months before we arrived back to $10 000.

Even though it took us longer to rebuild back the losses, let's consider it in a different way. During the first year, while we were consistently losing 10% a month, we ended up with approximately 75% loss - at $2500. The next year, when we started making 10% with the same consistency and reinvesting our money back at the end of the month, we arrived to ~$7850 after 12 month - more than 200% increase over the initial $2500 we had left.

Compound interest

In order to restore our $2500 account back in short amount of time, we used compound interest – any profits that we were making, were left in the account and we continued trading with them. The power of compound interest is well known, however in order to exercise it we need enough confidence in the system. It is OK if we just made 10%, invested it back into the market and the next month lost 10% - we are just 1% less than we were 2 months back. But what about a possibility of losing 20% or 30% the next month? Heck, without proper risk management, losing 50% or 80% the next month is just as easy!

Ultimately, the appeal of a trading method should be judged not as the extreme returns it promises the next month but as the consistency of these returns over the next 10 years and more.

Of course, the issue for starting traders is often a lack of capital. When you start with $1000, 10% a month does not seem to be that big of a deal at all. I would argue that the real issue for starting traders is lack of patience, followed closely by the lack of confidence in their trading method.

Here is another example: how much do you think the initial $1000 deposit will grow in 10 years using the basic 10% a month scheme we looked at, reinvesting the profits each month? The result will be an astonishing $92,709,068.82. Improve your edge by as little as 1% additional profit a month and you end up with $274,635,993.25 by the end of the same period.

So, the main question is not whether you find a way to make 20% a month instead of 10%. The main question is whether you are going to stick to your system and reinvestment plan after 5 years, when your $1000 has already become a respectable $304,481.64. After you increased your account 300 times starting with $1000, are you going to trust your system to do the same in the next 5 years, now starting with $300K?

There are two important points that were mentioned:

- The most important parameter of a trading system is its stability in long term performance
- The profitability is only relevant compared to the drawdown the system can experience

First of all, we need to realize that right now we are only discussing controlled drawdown - the amount of loss we will accept willingly when the market goes against us. Our ability to control that drawdown is also dependent on the market - we need a valid price in area of our stop loss in order to get out of the market. In situations of major crashes such control is not always achievable, as you are unable to exit the market at a desired price. Different risk control measures need to be used there, to be discussed in separate article.

Limiting monthly risk

Assuming normal market conditions when we can exit with our loss at a predefined price, let's discuss how we increase the appeal of our trading method.

Any profit outcome is only relevant relative to the amount of risk we exposed ourselves on the market. Let's differentiate between *the loss we experienced* and *the risk we were exposed to*. It is possible to finish the month in 10% profit with the highest draw down being 2%. That amount of draw down was our loss that we experienced in the course of making our 10%. However, it is not the risk we were exposed to. To me, the definition of the risk starts with the amount of *money we could have possibly lost if all our trades would have closed in a loss* - the worst case scenario, very rare, but possible. However, I would complete that definition by adding that the risk exposure is not only limited to the trades we actually took during the month but any trades we might have taken as well. Let me explain what I mean by that.

First, the drawdown that we experienced is simply the amount of money we were down during the

month. We opened 20 trades and at some point a series of trades resulted in 2% consecutive draw down. It might have happened at any time during the month. We still closed the month with 10% profit.

The actual risk exposure during that month is defined as the amount of loss we would experience if all the trades would have failed. If we risked 1% a trade, our actual risk exposure was 20% - that is the amount we would have lost with same 20 trades failing one after another. Unless, of course, our system is limiting the potential of our risk exposure.

The potential risk exposure is defined as the amount of money we would have lost on all the trades we could have entered, limited by our system rules. What I mean by this is that our trading system may strictly forbid any trading past a certain loss threshold. In our example throughout this article the potential risk exposure was strictly limited at 10%, because all the trading stops, if such a loss is reached in any given month. Of course, it is still up to the trader to honor such limitation, but that is a matter of trading psychology and not system Money and Risk Management.

Limiting daily risk

Coming back to the example, there is another extremely important limitation we established in our trading system. Not only we limited the potential risk exposure at 10% a month, but we also limited the risk exposure during any given day at 0,5%, ensuring that we arrive at 10% loss only by consistently losing day in, day out. Let's see why it is so important.

Imagine another system where potential monthly loss is also limited at 10%, but there is no such daily limit. The trader is using the system successfully, confident that he is well protected against any market surprises and will survive through the bad times.

Let's say on a certain day the trades sees a great opportunity to buy USD against other currencies. He then opens EURUSD sell trade and GBPUSD trade with 0.5% risk each - very conservative approach. The next day he sees that the market retraced against him and stopped out the trades, but fails to go any further, therefore confirming his bias that the USD bears are very weak. This time even better entries are available on USDCAD, USDCHF and USDJPY, along with the same EURUSD and GBPUSD. Excited, he buys first 3 pairs and sells EUR and GBP again.

Alas, the market is still trading sideways and his stops are narrowly hit. Frustrated, our trader starts looking for explanation with further analysis and sees that the market was just reaching a round number. Now that the level of support was hit, he is even more confident in the reversal, because his original signals stays the same - buy USD against other currencies. Looking at his loss of 3.5% with quiet disgust, he decides to make the money back fast, with a near profit target and puts 1% risk into the same 7 pairs. Predictable as markets are in such situation, his stops are taken before the price finally moves in his direction. The trader, however, already hit his 10% limit and even exceeded it by 0.5%.

Did I mentioned that *all of this happened in the first 5 days of the month*?

There are many problems with his risk control:

1. Because he didn't limit his daily loss limit, he was susceptible to trading on emotions as well as overtrading.
2. When the market was not presenting easy opportunities he managed to reach his loss limit in just a couple days and could not do anything for the reminder of the month.
3. Because there is no daily limit, the trading can become very poorly diversified - the trader risked 0.5% in a couple USD pairs, knowing that when they move they usually do so together in the same direction.
4. The trader is extremely frustrated with his performance and now the question is whether he will be able to honor his monthly limit or not - in his current mental state, when he already made a series of bad mistakes, he is risking to break other rules as well.

Now we can compare it to our original method, where the risk is not only limited to 10% a month but also to 0.5% a day.

1. When the market is difficult to trade the trader will have to choose the best trading opportunities or spread his 0.5% risk in a couple trades. In other words, such limit ensures diversification, since when the signal is presenting itself in

multiple related pairs at the same time, the chances are that the trades in these pairs will close in a loss or a profit together.

2. If the trader has bad attitude today and is susceptible to making errors, he will be forced to stay out of market very quickly, losing no more than 0.5%. By the next day he has enough time to cool down and trade with proper attitude.
3. Even the worst market conditions do not last very long and by giving himself freedom to lose money every single day and still be able to continue trading the next day, the trader is maximizing his opportunities.
4. Because each day presents a new trading opportunity, the trader is truly distributing the signals provided by his edge in a wide array of market situations, ensuring that no single event can affect his bottom line greatly.
5. The trader is better protected against force-major situations, since his risk exposure on the market is always limited. Even if the market trades through his stop loss, the damage will not be as devastating.

Summary

Besides protecting the account from being wiped up by a couple erroneous errors, such trading limitations are even more important psychologically.

When this risk management system is setup, the trader can work with more confidenc. The system allows him to know clearly what will happen not only if this trade loses, but also if every trade will lose until the end of the month. The trader can concentrate on finding his edges and acting on them. Each day he knows his limits, and he also knows that no matter what happens, he can continue trading for the whole month, looking at new opportunities each day, without the fear of hitting his loss limit.

In later issues we will be discussing different variations of managing the risk of trading. We will also look at profit expectations that we can realistically have when such risk limits are used.

Building analysis framework

Starting with the previous issue I introduced a new format of weekly market analysis. This week I continue working through all major trading pairs on the market in order to understand how the market behaved in the past year, slowly arriving to today's prices.

The work I am doing right now can be subdivided into 3 distinct phases:

1. First of all we need to build a framework to see the market in a certain way. During this phase I am going to analyze all 28 major trading pairs on history and try to find explanation why certain moves started and ended the way they did. Here I am using the benefit of hindsight, purposely finding the ideal point of reversal first and then thinking how it was possible to anticipate it or when was the new trend confirmed inside of our analysis framework after the reversal. I expect this phase to continue for at least a month and there will be a lot of charts to analyze in detail.
2. Second phase is to identify certain rules of analysis that we found during the first phase and then start applying them to the current markets, by following all 28 trading pairs bar by bar on Weekly and Daily as they unfold.
3. The last phase is to identify entry points in the direction of the prevailing bias that we find while doing market analysis.

With all this in mind I want the reader to understand the purpose of the current analysis that will be posted during phase 1. There will be no trading signals to follow and any speculation about further price movement is irrelevant at this stage, as we are trying to polish the analysis framework by learning from history.

Cross pairs and COT data

It is really interesting to analyze cross pairs, especially during the periods when both currencies are trying to push the pair in different directions. Another important point to remember on cross pairs is that the COT data is released for currency futures and even though it may seem that speculators are losing money judging by the cross pair, it is not necessarily so. When AUD Speculators are buying and GBP are buying as well, while GA pair is going up, it seems that the traders on GBP side are making money while traders on AUD are losing. In fact, they both can be in profits if the trend on GU and AU is up. GA is moving up only because GU trend is stronger than AU.

Once again, the main goal I am pursing at the moment is to overview the market on all major trading pairs during the past year and establish a framework that we can then use to understand the current market better. At the same time I am looking at different COT and price action patterns and analyzing how they acted in the past in order to establish the rules for practical usage in today's markets.

How to read the charts

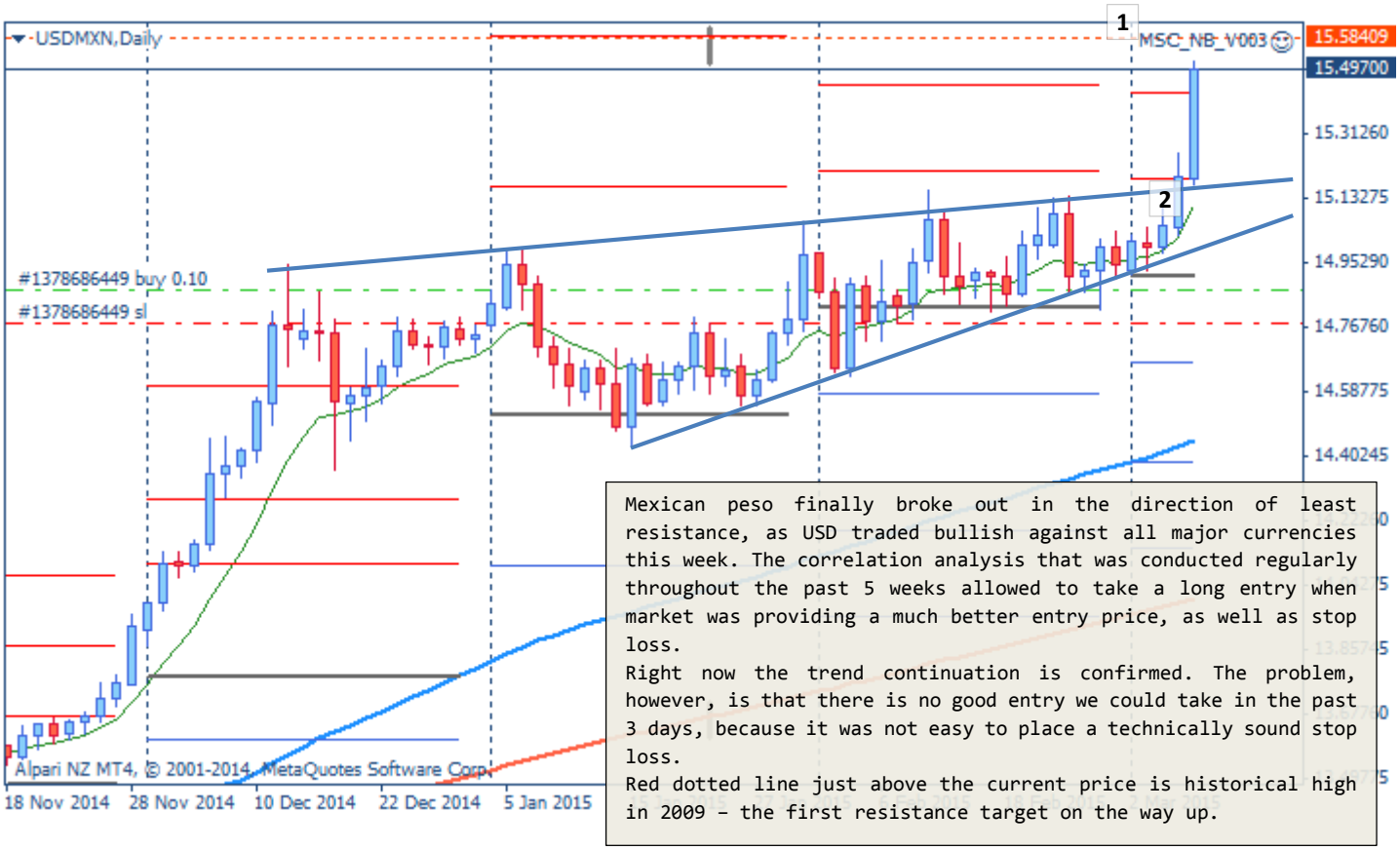
Because on Forex we are dealing with trading pairs, not currencies, each trading instrument consists of 2 currencies. COT reports are prepared for currency futures that are quoted in US dollars. Therefore an AUD futures will correspond most closely to AUDUSD trading pair - the difference in their price action is quite small indeed.

However, for trading purposes on Forex market I'd like to analyze both currencies separately, knowing that either can affect the trading pair in question. Therefore on my charts I will use separate data for the first currency in a trading pair and for the second. Because we will analyze Speculators short and long positions, we will have 4 lines overall. Using AUDUSD as an example, we will analyze AUD Speculators' short, AUD Speculators long, USD Speculators short and USD Speculators long. The most bullish sign for AU would be AUD shorts decreasing, AUD longs increasing, USD shorts increasing and finally USD longs decreasing. Notice the reversed relation between USD COT positions and AU price action. If we want to place a bullish bet on AU, we want the AUD currency to increase in value and USD currency to decrease in value - this results in the strongest move.

Detailed introduction, as well as indicators to see COT data in MT4, can be found in Meta COT article.

Finally, let's take a look at a picture showing a legend how to read these charts.

USDMXN Daily



Mexican peso finally broke out in the direction of least resistance, as USD traded bullish against all major currencies this week. The correlation analysis that was conducted regularly throughout the past 5 weeks allowed to take a long entry when market was providing a much better entry price, as well as stop loss.

Right now the trend continuation is confirmed. The problem, however, is that there is no good entry we could take in the past 3 days, because it was not easy to place a technically sound stop loss.

Red dotted line just above the current price is historical high in 2009 – the first resistance target on the way up.

Oil Daily

Unlike peso, the Oil is still staying inside of the range between the February's pivot and R1 resistance (bold gray and thin red lines). The price started bullish in the beginning of the week, but then was pushed down, below the March's pivot.

Because of the current position of Oil prices inside the range, it is an invaluable indicator for the trend in Peso. If the Oil manages to break below the range, it will fuel the trend in Peso even further and we can expect the high of 2009 to be taken without too much problem. If the Oil reverses up and breaks the upper boundary, the trend in Peso can halt.

AUDUSD Monday, 2nd of March 2015

Abbreviations:
AU – AUDUSD
NC – Non-Commercial
TL – Trendline
TF – Timeframe

(1) The COT positions started becoming bullish, as AUD Long were rapidly rising and AUD Short falling, crossing at this point. USD Short and USD Long were about the same level. The price was reaching the yearly pivot.

(2) 12 weeks later we can see AUD Long accumulated a very high volume, with AUD Short still low. The price was not able to increase at all, as it was trading in a range between the yearly pivot and 20 EMA. This is a very interesting sign all the bullish volumes could not move the market any higher in 3 months, with bearish candles aggressively cancelling any bullish price action. We can also see USD becoming increasingly bullish with higher USD Long and lower USD Short.

(3) 8 weeks later AUD Long still trying to push up with price now trading at the EMA. USD Long have risen quite a bit indicating bearish pressure for AU. The next week closes very bearish, breaking below the EMA and the lower boundary of the range. The AUD NC were still buying indicated on the COT chart. This is a very strong bearish signal – you can imagine all the traders on the wrong side of the market with their losses rapidly increasing. They will have to start bailing out, selling their longs, and it will push the market even lower. The same can be said about the USD Short who found themselves on the wrong side of the market as well and started taking their losses together with AUD Long.

(4) AUD Long have been dropping lower each week, while AUD Short started rising. USD Long are high as well, with USD Short very low. All of this means that NC speculators are very bearish on AU. Let's keep in mind that it still does not mean the price should be going down nonstop. The price action always comes first, but it is when price action is aligned with the biggest players is what we are looking for. Correction has started at (4), allowing us to look for short entries on Daily TF.

(5) NC traders are even more bearish on AU. The price has retraced exactly to the bearish TL on Weekly chart. Looking at Daily, we can see the price being rejected from the January's pivot – a perfect entry signal along with the bearish trend.

(6) No signs of reversal neither on COT data, nor on Weekly or Daily TF. On Weekly the price bounced from the TL once again. On Daily it reached February's pivot and bounced down as well. On H4 the reversal lined up with the red 200 EMA.

I would be careful selling at the current levels as the price is slowly moving into the past support, marked with red dotted line.

NZDUSD Monday, 2nd of March 2015

(1) Just like in AN we are starting with a huge spike in NZD selling. As the price on NU was approaching its long term high, it was a very telling signal. However, NZD longs were still much higher and USD was undecided. Obviously one side had to start losing money on NZD before the picture would become clearer.

(2) The week closed down, below the past 2 bars. It is a very interesting bar: NZD longs are still high, as they are not experiencing any losses while almost half of NZD shorts bailed out, probably happy to close their trades in breakeven. USD started lining up bullish with shorts decreasing and longs increasing.

At this point the bias becoming increasingly bearish for NU. Note that NZD longs reached its past levels but they were still unable to push the price to the new highs. The next week, as the price went further down and closed below the EMA, the bulls who bought since (1) started losing heavily. On contrast, all bears are now in profits.

(2) - (3) During this strong trend most large speculators started catching up in their positions. NZD longs were scaling out on the way down. It is important to remember that the COT data shows only the summary of all Large Speculators. Some of these traders maybe trading the trends lasting a decade and they can afford to exit very late. No matter how low the price will reach there will always be some traders willing to hold buy positions.

USD longs were increasing together with USD shorts for about 6 weeks, but during the last 3 weeks before (3) they had to start accepting their losses, as the price broke down below the yearly pivot and 200 EMA.

(3) - (4) This was a period of a lengthy sideways market moving a little bit down in a channel. The market needed time to absorb the huge trend between (2) and (3). The fact that the price was hardly able to retrace during this correction is very telling and emphasizes the remaining bearish pressure. Note COT data: both long and short positions for NZD and USD stayed virtually the same for the whole period.

(5) All COT stay the same, except USD longs that reached a new long term high. At the same time the weekly bar opened just above the upper channel line, only to close below it. This is a good bearish sign in line with the overall trend during the past half a year. Going to Daily now, note the big bullish bar pinching the recent high and then closing below. That was still a risky signal to sell, but a good SL was available. H4 could possible offer a better entry.

(6) The COT one again aligned bearish for NU (very bullish for USD and increasingly bearish for NZD). The price correct up in February meeting a lot of resistance at the pivot. The trend is still bearish on Weekly and we can start looking for sells when the price breaks below the green EMA on Daily with enough build up. Note blue 100 EMA on H4 where the price stalled this Monday.

EURAUD Tuesday, 3rd of March 2015

Abbreviations:
EA – EURAUD
NC – Non-Commercial
TL – Trendline
TF – Timeframe

(1) The price has just broken below the 20 EMA on weekly indicating a possible start of the new trend. AUD longs have been increasing a couple past weeks, while AUD short were decreasing. EUR longs and shorts remained largely unchanged, so we can speculate that the trend was fueled by AUD speculators at that point. At (1) COT reached turning point, speculators became net long on AUD.

Note (a) where the price retraced back to 20 EMA providing a good price action pattern to watch for possible sell entry on Daily.

(2) Now EUR speculators became net short, further confirming bearish bias for EA.

(3) As the price got to the 100 and 200 EMAs support the COT was lined up very bearish for EA. When the next week closed very bearish below the EMAs and another week followed with an unsuccessful test back to the same level, confirming that prior support now became resistance, it seemed that nothing will stop that trend. With the benefit of hindsight we can see that it was not the case.

(4) This week closed up, cancelling all price action in the previous two, breaking through the EMAs and stopping only at the yearly pivot. Such a move does not seem to make any sense in terms of COT data, as all the volumes were lined up very bearish for EA. There are 2 important points we have to remember in order to understand such moves:

1. The price always comes first – even the largest market participants that we are watching on COT data will lose money at some point as they cannot predict where the market will go. They are playing a probability game, just like we are.

2. The COT data is reported for currency futures. These traders are not trading EA trading pair, they are buying and selling AUD future and EUR future separately, as explained before.

The reasons for this move are covered in detail in last week AU analysis.

(5) With both EUR and AUD now lined up down on COT data, we cannot expect any consistent long term trend on EA. The best conservative decision is to avoid trading such pair. Aggressive choice is to analyze price action and see which side is more likely to give up when the price is stalled. Here at (5) is a great example of both currencies struggling for leadership, as the price is locked between 2 EMAs and yearly pivot for a couple weeks. When the week after (5) closed very bullish there was a good entry available on Daily chart (see 1st-3rd of December).

(6) The price reversed on Weekly once again, with the COT speculators still aligned sideways for EA. We could use the knowledge that the bullish trend from (5) to (6) is not supported by both currencies and try to trade against it in the area of (b) when the price broke below the red support level and then 20 EMA.

GBPAUD Tuesday, 3rd of March 2015

Abbreviations:
EA – EURAUD
GA – GBPAUD
NC – Non-Commercial
TL – Trendline
TF – Timeframe

(1) Unlike EA, GA COT speculators were buying both GBP and AUD (in terms of their net positions) the first half of the previous year, resulting in a sideways market for many months, 20 EMA going flatly through the price. Notice 2 strong bullish bars trying to break the upper flat boundary at (a) and (b) but failing each time – very good signs of bearish control in terms of price action. The bar at (b) resulting at a triple top as well.

Just like with EA it was very hard to trade the strong week at (1).

(2) After the price broke above the past flat boundary (dotted line on (a) and (b) highs), it was pulled back by the bears and traded in that area for 6 weeks before breaking below on the bar prior to (2), stopping at the lower boundary of the same flat earlier that year (red dotted line). We can see AUD shorts dominating the COT chart, however GBP longs are very low as well and GBP started to increase. The overall picture is still much more bullish for GA than it was for EA the same time of year.

Even though it is not the best trending market, we could have started looking for buys after the price broke back above 20 EMA along with our weak bullish premise.

(3) Still very little speculators are buying either GBP or AUD and short positions are dominating for both currencies. In this situation our premise is based only on price action. With the bearish move coming ~50% of the previous bullish leg, only to rest on triply support of 20 EMA, yearly pivot and bullish TL, the premise for the weekly trend is clearly bullish.

Going down to Daily TF we can see the price trading in the support area, unable to break the prior low for 3 days before starting to move up at (c). As the price closed above EMA there was a good chance to enter on the correction on the next day (3rd day of the bullish move in the area of (c)).

(4) The price bounced from the round number level 2.0000 and started a sideways move lasting for more than 2 weeks already. AUD shorts reached a new high but once again, GBP is not supporting a bullish move on GA.

(5) The price was not able to break neither side of the range, being squeezed by the pattern line above and 20 EMA below. The overall pressure remains bullish, but if the price manages to break below the EMA and the lower boundary of the range, a lot of bearish volume will enter in the market, both sideline bears selling and bulls bailing out of their positions.

Notice false bullish break at (d) that was quickly faded by the bears. On H4 we can see that the bears were cancelling any up moves very aggressively and down candles were much stronger overall in the past couple days.

In any case, given the lack of clear bias in COT data and the price trading in the range, both sides are risky at the moment.

EURNZD Wednesday, 4th of March 2015

Abbreviations:
EN – EURNZD
AN – AUDNZD
NU – NZDUSD
NC – Non-Commercial
TL – Trendline
TF – Timeframe

(1) The price is trading below the 20 EMA, recently broken the yearly pivot. On COT NZD speculators are mostly long while EUR is much less decided, with longs being only a little bit higher than the shorts. Our general bias is bearish.

The current week tested the combined level of EMA and the pivot but bounced from it, allowing us to look for sells on lower timeframes.

(2) Now EUR speculators became net bearish while NZD still remains strongly bullish. The price tried to break above the EMA but was rejected. The premise is very bearish.

(3) As we've already seen on AN and NU charts, the spike in NZD selling cannot be ignored. The market continued down for another week and then reversed.

Note that EUR sells are on the rise and the price is still below the EMA so it is hard to expect a major trend reversal.

(4) The price has stalled on the EMA for 6 weeks, unable to break it. NZD longs were bailing out in the meantime (bullish for EN) and EUR shorts continued to increase (bearish for EN).

After the price closed in a strong candle above the previous 6 weeks and the EMA and then retraced right back to the EMA it was a signal of NZD speculators shifting the balance of power on their side. Buying is risky, however, because there is only support of one currency to do so. The goals would be the blue 100 EMA and yearly pivot.

(5) The previous week closed right on the 100 EMA and the next week broke through both EMA and the pivot. Imagine how that candle looked when the price was trading near its high – it certainly seemed that NZD bears have won that battle. After the candle was rejected and closed below the pivot a change of plans was in order.

The price continued to trade sideways for 5 weeks, not able to break the pivot even once. With EUR sells further increasing the premise was certainly changing to bullish, given the pressure build up in this area.

(6) After the bears have won the previous battle, the bulls managed to get the price back above the 20 EMA and tested the 100 EMA as well. The balance of power on COT chart remains largely unchanged.

The next week closed very bearish, breaking the previous 2 weeks and the 20 EMA. Note how the price briefly tested the 100 EMA again – when we see the bulls still struggling to push the price up but ultimately completely failing at it, it is a very good bearish sign.

(7) The bulls managed to pull off another correction back to the EMA, but the bears were protecting that level and forced the price to close below on each week.

Going down to Daily, notice how a bullish bar broke above the January's pivot and tested the 200 EMA, only to close below – it is this type of signals we are looking for, along the path of least resistance on a higher TF.

GBPNZD Wednesday, 4th of March 2015

Abbreviations:
GN – GBPNZD
GA – GBPAUD
NC – Non-Commercial
TL – Trendline
TF – Timeframe

It would be difficult to choose a worse trading pair in terms of a trend during the 2014. The speculators on GBP and NZD almost mirrored each other, consistently taking the same side on both currencies. As we are looking at the cross between GBP and NZD here, we need them to be pushing in the opposite sides in order to see any consistent trend and that did not happen in the past 12+ months.

Let's look at a couple areas and try to analyze the balance of power for educational purposes.

(1) Slightly bullish area, with the price moving up in a sideways channel. The price was rejected below the yearly pivot and then was struggling its way through the EMAs, stalling for 4 weeks in the area of 20 and 100 EMAs. It ultimately reached the 200 EMA but was rejected above it.

The COT data is strongly bullish for both currencies, forcing the trading pair to bounce from one direction to another in a sideways move.

Because of the way EMAs were going flatly through the price, we could have assumed after the bounce at the end of area (1) that the sideways market can continue for a long time.

(2) Completely sideways market, even more so than (1). After the bounce from the 200 EMA, the price retraced back to 100 EMA and was trading up and down around it for 6 straight weeks. It finally reached the 200 EMA again, only to stale there for another 6 weeks and go down.

Notice that the spike in NZD shorts had very little effect here, as GBP longs started dropping around the same time.

(3) The same strong move that we saw on GA and EA happened here as well. The week at the start of (3) opened below the 100 EMA with a big gap and was instantly bought up until it closed above the previous week and 200 EMA. The next week we could see a spike in GBP buying on COT data, suggesting that the bias became slightly bullish. Trading this move would not be a good idea, in view of overall situation on GN.

(4) This period started with the price being violently rejected from above S1 level. At the same time both GBP and NZD COT became undecided, with shorts and longs being about the same.

(5) Here GBP COT became bearish while NZD was still undecided, finally providing at least some real bias to work with. At the same time the price reached the bearish TL and was instantly sold from there, resulting in a much lower close. This gave us a reason to look for sells on lower TFs.

(6) The price started down very slow as it was struggling through 20 and 100 EMAs on Daily. When it finally broke below and then retraced up to the 200 EMA there was an opportunity to sell. Bearish bias was even further confirmed at (a) when the bulls managed to force the price back to 100 EMA, only to be rejected and pushed much further down.

USDCAD Thursday, 5th of March 2015

Abbreviations:
UC – USDCAD
NC – Non-Commercial
TL – Trendline
TF – Timeframe
R1 – Pivot Resistance 1

(1) Looking back into 2013, the pair was already going up, as we can see by the relation between the first bars on the chart and 20 EMA. CAD shorts just starting to rise while CAD longs are stagnant at a lower volume. The next couple weeks showed increasingly bullish bias, as USD shorts were bailing out as well.

(2) CAD shorts reached a new high, the price still trending strongly up. CAD longs are very low and USD is undecided – still bullish bias.

(2)-(3) The price retraced and then struggled to break higher until the bullish bar at (3). The CAD shorts are still strong, retracing somewhat, suggesting that market is shaking off weak participants. We are getting ready for another bullish leg.

One worrying sign for UC bullish though is the fat that USD short have been on the rise as well a couple past weeks. USD longs were also rising, cancelling the shorts out.

(3) The bullish bar at (3) broke above the previous high, but the bears managed to push it back and it closed at the high. We are still expecting continuation.

The next bar is crucial for a couple reasons. It cancelled the previous bullish price action completely but more importantly we can see the CAD bears pressing on, greatly increasing their volumes that week and still unable to hold the price. We now know that a lot of big players are trapped in losing positions and will have to bail out, pushing the market even lower.

Note the decrease in USD Long volume, along with increase in USD Shorts. In this battle USD bears were clearly winning.

(3-a) The price has bounced from the 20 EMA and yearly R1 level, resulting in a correction. Looking closer on Daily, we can see the bars getting smaller as the price raises. Finally the price stalled on 20 EMA on Daily for 8 days before breaking down in a strong bearish bar. As it is a break along with the weekly bias, we can look for some trades.

(3-b, 3-c) The price corrected back to 20 EMA on Daily. Looking on H4 we can see 2 signs of increasing bearish pressure. At (b) the bulls tried to push above the recent high a day before but were rejected. At (c) the bulls tried to break back above Weekly pivot, only to have all their efforts cancelled the next bar. Both good entry setups.

(4) Back on W1, the premise is changing again, as USD longs went above USD shorts and the week after (4) closed strongly bullish. Note that CAD longs also went up, ultimately resulting in two currencies pushing UC in different directions.

(5) CAD longs started to bail out, clearly in losses. USD Shorts went higher, once again, not allowing UC to have a clear bullish bias. The price became squeezed between 20 EMA and R1.

(6) The price broke up, USD shorts bailing out, CAD longs are almost gone. Now we have a clear bullish bias. The next bar corrected to R1, allowing us to look for buys.

EURCAD Thursday, 5th of March 2015

Abbreviations:
EC – EURCAD
NC – Non-Commercial
TL – Trendline
TF – Timeframe
R1 – Pivot Resistance 1

A stronger trend before (1), compared to USDCAD, as EUR shorts were relatively stagnant.

(1) Both EUR longs and CAD shorts are on the rise as the price reaches the new highs. As the strong bearish bar closed down, cancelling the price action the past 3 weeks, we know that there are many EUR bulls and CAD bears stuck in a loss. During the next couple weeks virtually all losing traders bailed out, while the price was correcting back to yearly R1.

(1-a) During the correction we should start looking for possible shorts on lower TFs along with the weekly bearish bias. At (a) a good opportunity presented itself, as the price could not break above the April's pivot.

If the trade was missed on Daily, H4 offered multiple opportunities when the price retraced to weekly pivot and bounced from it 3 times at (b), (c) and (d).

Finally, the bulls tried to fight back at (e) – imagine how that bar looked before it was aggressively sold back below the pivot and the lows of the previous 2 days. A very bearish signal confirming our long term premise.

(2) EUR longs and CAD shorts reduced further, while both EUR shorts and CAD longs were increasing, further reinforcing the bearish premise, At the same time the price retraced to 20 EMA on Weekly and combination of May's pivot, 20 EMA and 100 EMA on Daily. After the price bounced from there and a day closed down we have another entry confirmation.

(3) Weekly bar being rejected when trying to set a new low, while COT volumes have been pushing the pair down – a worrying sign and a potential reversal. During the next 2 weeks CAD longs started bailing out as the price was rising; EUR shorts continued to grow. All these signs would've led us to consider a trend reversal EUR shorts also start accepting their losses and closing their positions. The price also had 20 EMA on the way to break.

The bias is still bullish, so we cannot start buying against it, but closing long term trades in profit would not have been a bad idea.

(4) As the week closed very bearish, bouncing from 20 EMA, it was confirmed that the trend reversal is not happening and allowed us to look for new shorts. Of course, the possibility that another bullish attempt could have broken above 20 EMA was there, but that's what SL is for.

(5) The price stopped on both yearly pivot and 200 EMA while most CAD bulls bailed out already, leaving EUR bears the only one still pushing the price in EC down. When only one side is aligned with the trend the premise becomes much weaker.

(6) By this time CAD speculators increased their selling against EUR selling and the price failed to break below pivot on at least 3 separate attempts – we are getting ready for a sideways market. The combination of 100 EMA, 200 EMA and 2014 pivot in the area make it very difficult to break.

GBPCAD Thursday, 5th of March 2015

Abbreviations:
GC – GBPCAD
NC – Non-Commercial
TL – Trendline
TF – Timeframe
R1 – Pivot Resistance 1

(1) The trend was already going up, pushed by CAD selling, and started to retrace a bit. We ignore any selling against bias, so this was an opportunity to look for buys. An important signal is that GBP longs now joined bullish pressure on GC as well, breaking the previous level (dotted blue line on COT chart).

(2) The price action has slowed down as the price reached 2014 R1 resistance. Just before (2) the price retraced to the TL, providing another buying opportunity. CAD shorts reduced by did not break the previous level (red dotted line). GBP longs reached a new high. Our premise is still bullish, but seeing that many large traders committed themselves to the long side, we need to see the price confirming the direction and breaking to the new highs.

(3) GBP longs somewhat reduced but CAD shorts reached much higher. The price went down but was rejected from the R1. The important bar is the next, when the price broke the support down and we saw CAD shorts bailing out. Unlike EC or UC, however, GBP was still pushing the pair up, providing that we have to be cautious trading in the new direction without confirmation.

(4) The price reached back above R1, CAD shorts reduced further, but now GBP longs greatly increased. The bias is no longer bullish but it is neither bearish, as GBP and CAD traders are pushing this cross in different direction.

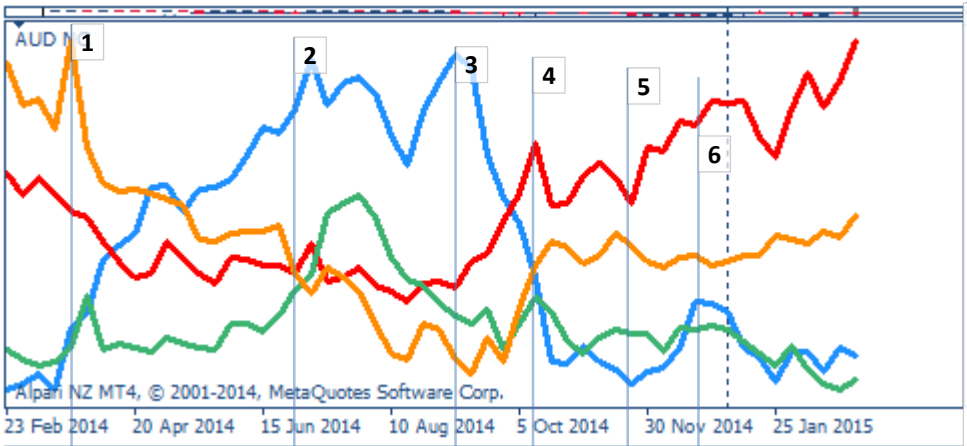
As we saw later, the trading pair started in a prolonged sideways market from (4) to (6).

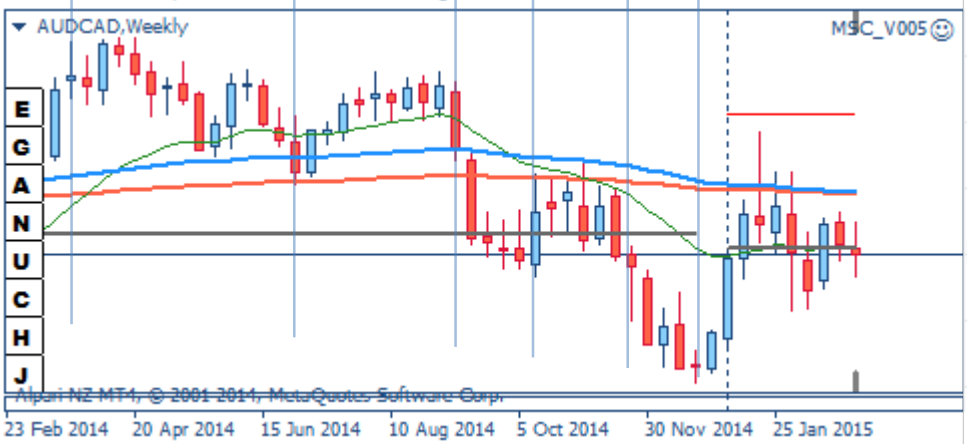
(5) GBP longs reaching new highs while the price is testing 20 EMA and previous low. A possible aggressive entry for contrarian traders, but very risky. Not worth it.

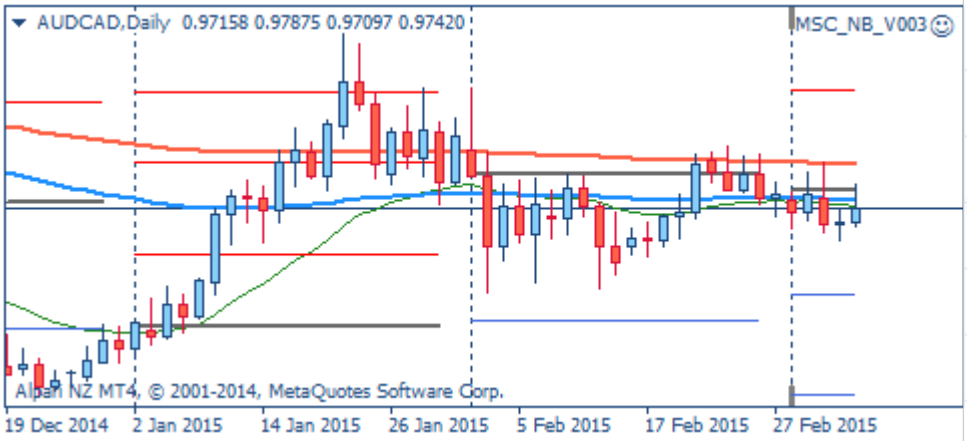
(6) We saw CAD longs increase and fall back down between (5) and (6), while CAD shorts decreased even further. After GBP failed to push the price further up, their longs also decreased considerably. At (6) we came to test the previous low support once again – this time breaking 20 EMA first. The bias is slightly bearish, but as the bulls failed to push the price any higher on multiple occasions (there were 4 rejected bullish weeks between (4) and (6)), an aggressive sell breakout entry is not inconceivable.

(7) All large market participants greatly reduced their volumes now with both GBP and CAD being about net zero. We can hardly expect anything from this cross pair at that point.

AUDCAD Friday, 6th of March 2015







Abbreviations:
AC – AUDCAD
AU – AUDUSD
UC – USDCAD
NC – Non-Commercial
TL – Trendline
TF – Timeframe

In order to understand this cross chart, we need to refer to AUDUSD and USDCAD to see the correlation and COT positions. It is important to remember that COT data is released for currency futures and on cross pairs we do not see where the traders lose money.

(1) CAD shorts spiked up, trying to push the trend further up. On UC it is easy to see that the price did not honor those position and trapped traders in losses, forcing them to start bailing out on the next bar – a strong signal that the price is not able to go any higher for fundamental reasons. On this cross, however, AUD longs started pushing up around the same time, while AUD shorts started decreased resulting in 2 currencies pushing the pair in different directions. It would be an aggressive bet to trade against AUD, assuming that CAD will win the battle.

(1)-(2) The price was slowly moving down with one considerable retracement from green EMA. AUD longs continued increasing, but as we look on AU chart, we see that the price stalled at yearly pivot, unable to break it despite all bullish pressure. It seemed that the price is ready to collapse at any moment and it is held in place only by aggressive buying from the speculators. It could not go on forever, sooner or later whether the price would break up or the longs would start accepting their heavy losses, resulting in a huge break down. After such build up a big break is always expected (see AU for details).

(2) CAD shorts have been decreasing and CAD longs increasing until their reached a crossing point – CAD became net long. However, on the same week the price reverses its direction, trapping the traders in losses.

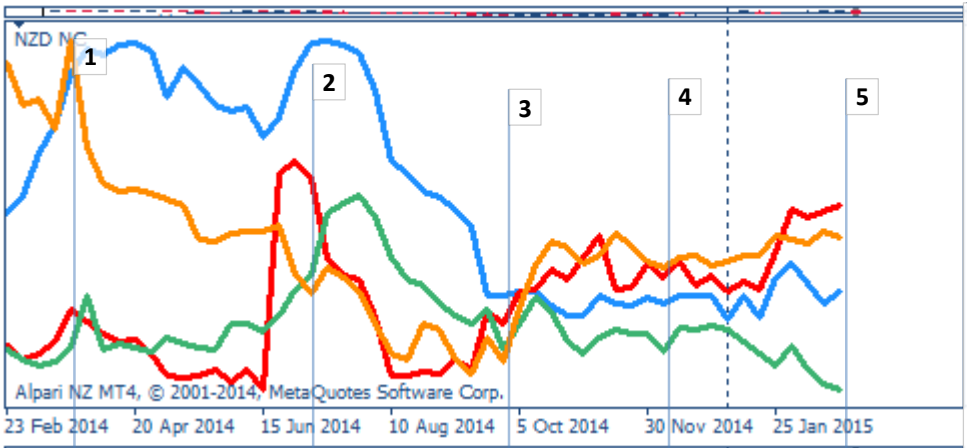
(3) AUD longs increased yet again, reaching the previous levels, trying to push the price up. The week closes extremely bearish, finally breaking the range (see AU). It seems that if AUD buying could not reverse the trend up at (2), the same amount of buying again will not be enough a couple weeks later at (3). With CAD being more or less neutral, this was the first opportunity to take action after the first bearish week.

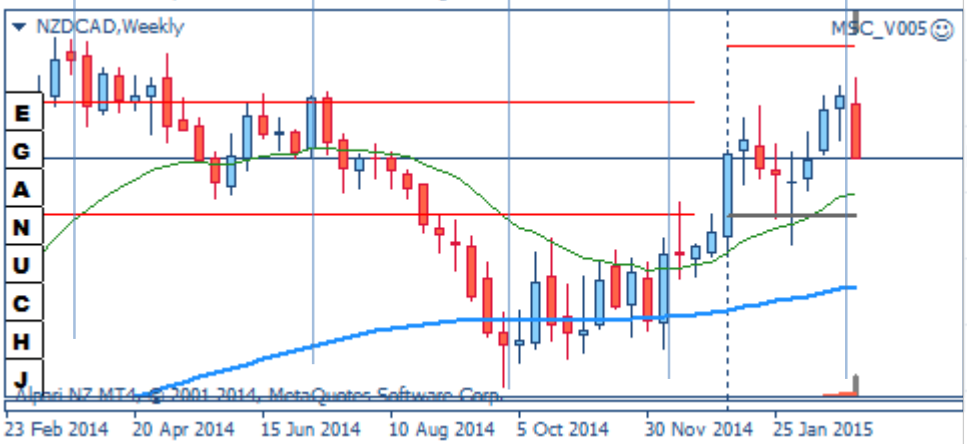
(4)-(5) The price did not manage to break through the pivot on the first attempt and was rejected. CAD shorts rapidly increasing helped to move the price up. However, the price met resistance at 100 and 200 EMAs and traded sideways for a couple weeks.

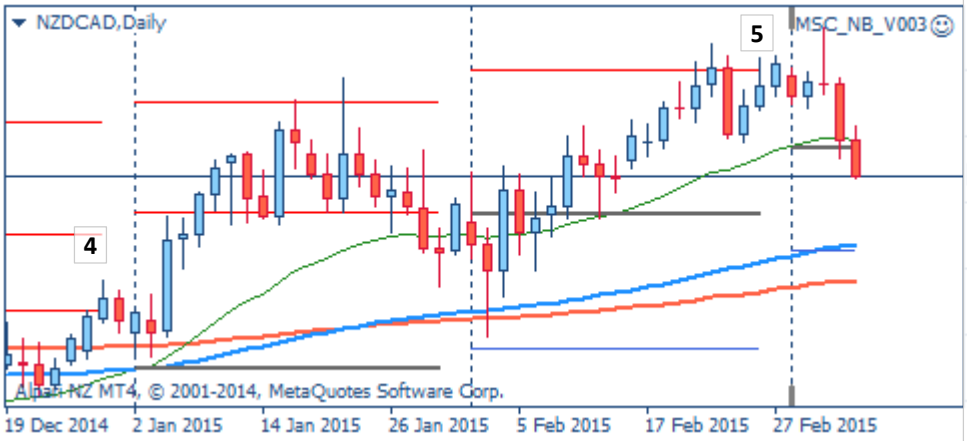
(5) With CAD pushing the pair up, the bias now is only slightly bearish for AC and bumpy trend is expected.

(6) The trend reverses once again, this time favoring CAD speculators. On UC we can see that the price goes up in a strong trend, pushing AC also up. On AU, however, we saw only a small correction on the same bars. In other words, even though AUD and CAD speculators are pulling AC cross in different directions, both are in profit and the trend on AC is defined by the relative strength of each currency.

NZDCAD Friday, 6th of March 2015







Abbreviations:
UC – USDCAD
NU – NZDUSD
NC – NZDCAD
TL – Trendline
TF – Timeframe

(1) The same as on other CAD pairs, bears tried to make the last push but failed and market reversed against them, giving a strong bullish signal for CAD. However, we can see that NZD traders are also bullish and NC cross is expected to be pulled in different directions.

(2) CAD shorts still reducing and the longs started to grow. On NZD we have extremely strong selling that we looked at before. Note also that NZD longs have reached their previous level, while the price is much lower (NU hardly managed to reach the previous high, stalling at it). Combined with situation on CAD we expect the market to start a strong bearish trend if it is unable to go higher.

After the bearish candle closes next week we start looking for shorts. The price then stalled below 20 EMA, absorbing all the selling, but the premise remained the same, so we just wait for it to continue.

(3) By the time the price reached here both NZD and CAD traders became neutral, with their shorts and longs pretty much cancelling each other out. The trend has not yet reversed but we could see this as an early signal that it is running out of strength. Yet, with no signals of strong reversal, we expect sideways correction, absorbing the selling in the past couple months.

(4) The premise changed to slightly bullish for NC: notice the distance between CAD shorts and longs compared to that of NZD. While both are net short, NZD is close to neutral.

After the price breaks above the range and 20 EMA we start looking for buys. As it retraces back to the EMA, unable to break below, the opportunity is there. Coming down to Daily we can see the price breaking above 100 (blue) and 200 (red) EMAs, then retracing back to 200 on two consecutive days, each day rejected and closing above.

(5) NZD selling has increased, but CAD is still net short, with the longs bailing out. The price action suggests down on NC cross, as we see the price rejected from the new high 3 days ago and then coming down strongly, breaking 20 EMA and the pivot.

Ideally we want to see one of the sides – NZD or CAD – to start bailing out, accepting their losses. As we look at USD pairs – NU and UC – we can see that there are bearish for both NZD and CAD, indicating that being net short is still profitable for large speculators. Accordingly, the trend on NC is only fueled by the imbalance of strength with which these two currencies push the cross in different directions.

Our expectation is to see a sideways correction and try to find if there is a clear sign that one currency is stronger than the other before taking any trades.