

FOREX



**USING FUNDAMENTAL ANALYSIS &
FUNDAMENTAL TRADING TECHNIQUES
TO MAXIMIZE YOUR GAINS**



DAVE MATIAS

Forex:

Using Fundamental Analysis & Fundamental Trading Techniques to maximize your Gains.

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Foreword:

I wouldn't recommend reading this publication if it is going to be your first book on Forex, or you have no prior experience. Try other entry level guides first, and come back to this one after you've gained some experience. This is also not a book on how to become a Fundamental Analyst, this is a beginner's guide to Fundamental Trading. This is the practical book on how to make sense, take advantage and trade, off of widely available Fundamental information for profits in Fx Markets.

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Introduction:

I wrote this book in a non-conventional way more like an info-guide rather than in a boring academic way. As a matter of fact, I wrote it as a reference guide for myself, in case I start deviating from my trading processes. I also thought it would be a good idea to get feedback from other readers and traders as well.

I have been trading Forex for over nine years now. Today I share the knowledge, and the experience that I've accumulated. The whole aspect of Trading, its Macroeconomics, Fundamental Analysis and Psychology have always fascinated me. At the beginning of my trading journey like many other Fx traders, after taking a quick course on Forex, I've gained the extensive share of my insights the hard way.

Some Fundamental Trading Myths to dispel.

Forex may be the marketplace that is largest in the world as it is the biggest financial market. Money changes hands in a click of a button, and fortunes are made as well as lost within a matter of seconds. Economic markets respond with the sheer force of traders' mass psychology. This is actually the valid reason why it is so saturated in **rumors** and **fables**. Below I've listed several Fundamental Trading myths to be aware of.

Trading Forex is No different than any other Markets.

Actually, it is. Forex is a very specific Marketplace, not only it trades 24 hours 6 days per week, but it has the highest leverage available than any other Markets. These two factors are among many reasons that make it so difficult to speculate on a daily basis. When trading Forex, we also have two currencies in one trading instrument; one being the "product" another - the "money". This fact alone adds another layer of complexity to ever-changing trading dynamic. We as currencies traders have to monitor not one, but two trading assets; this means following not one but two Economies. Considering how many **economic releases** are coming out just on one currency **on a monthly basis**, yet we have to factor in another currency's releases as well.

I can't make any money from Forex because it is rigged and controlled by the Central Banks.

It is said that Central banks and Governments can control a currency's price, after all, it is one of their mandates. Here is the truth: currencies change rates too often and too rapidly creating Volatility hence making it very hard to rig the Game. A country's currency can be manipulated only, to a certain extent. Market is an Auction process, and like in any auction, different perceptions of value lure participants to enter at distinctive price points and bid. Consider this, the only person accountable for your weak trade performance is you. **Therefore, get educated and you will profit from it. You as a retail speculator are there in order to find an edge.**

You find an edge by applying your knowledge, your very own trading strategy and preparation, to trade what the Market reveals to you. You recognize an

opportunity and you hit it hard with no regrets, no sorrows, because you've done your homework, and you were prepared. **Bear in mind, trading can be simple, but is virtually never ever easy.**

You should be an expert economist to trade forex.

Well, yes and no; Economic climate drives the forex market. Overall economy reflects within the major trend of the forex market. However, it doesn't suggest that you need to be an economic expert. If you possess an economist's knowledge, then it is a plus. Nonetheless, you still can buy and sell currencies effectively with no academic insights of economics. **Truth be told, there are many reputable analytical websites that can provide Fundamental estimates and analysis.** These sources can help you to comprehend economic elements with ease. Nowadays, the structure and the content of economic reports are the same for private banks as well as for retail traders. Knowing the Fundamentals is only a part of a puzzle. **Effective forex dealing requires patience, learning Fundamental market trends, rigorous money management, and discipline.**

The Four pillars of Trading - the Four pieces of the puzzle.

The majority of people make trading significantly more complicated than it requires to be. Even though it is not simple to realize success at trading, **it really is a lot easier if you break it down into its key components**. If you choose to do that, you will find actually only four items of the “puzzle” that you need to devote yourself to. While you're investing your energy and time on anything apart from these four components, you are merely complicating the trading processes.

Bottom line: these are the four pieces of the puzzle – Fundamentals; Technicals; Trade Management; Money Management.

Which one should you choose, Fundamentals or Technicals?

Fundamentals are as important as Technicals in Fx markets, in my opinion, even more important. Big Trending moves and Trend changes happen because of Fundamentals. **Fundamentals are the primary drivers of Fx Flows**.

If you grasp this concept and arrange your trading around the Fundamentals, you will be more successful at currencies speculations.

It's like building a house everything starts from a solid foundation.

In Fx Markets, Fundamentals are the Foundation on which you can build solid trading methods.

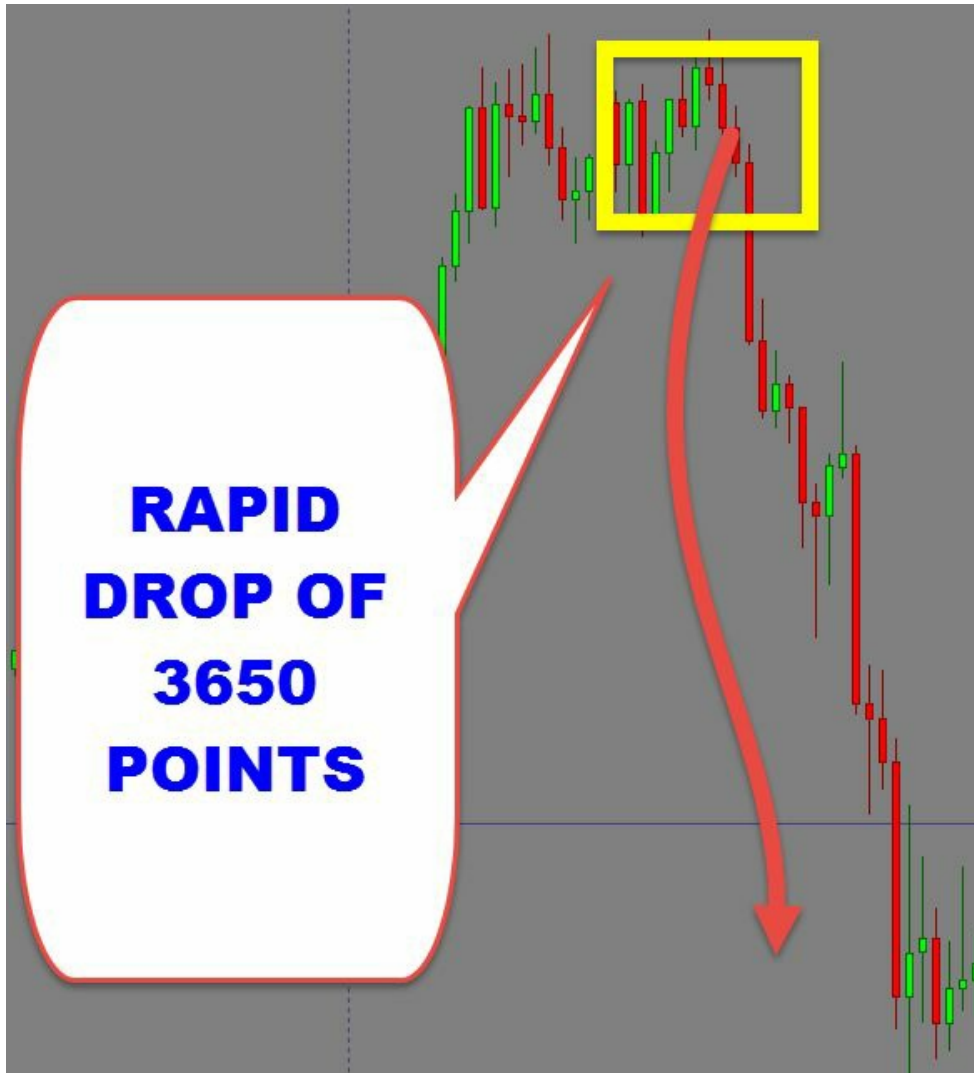
Why would anyone genuinely believe that Banks, Investment Funds and everyone that falls directly into “The Smart Money” category trades anything other than Fundamentals? As a matter of fact, for this reason, a lot of forex traders are not successful since they're **over focused on Technicals**.

To prove the point, here are some examples:

**MASSIVE RUN - MORE
THAN 4000 POINTS
MOVE!!!**



EUR/USD pair 2006 – 2008. Period of a fast credit growth, expansion of real estate, low-risk costs and abundant liquidity.



*EUR/USD in August - 2008 US Crisis. Period when American property owners **defaulted on** their mortgages. Banking institutions all over the world with financial investments linked to those mortgages began to lose their funds.*



EUR/USD, October – November of 2009. Europe slips into recession. European financial institutions that had invested intensively in the US mortgage market were hit hard.

All of the above examples were driven by Fundamental events.

Don't get me wrong, I'm not against the Technicals, all I want to relay is that Technicals have their own time and place in Trading.

This was a pivotal point in my trading journey when I came to a realization of what

to pay attention: master the Fundamentals, use the Technicals to find good entry points and exits, properly manage open trades, employ strict money management for protection.

Conclusion:

If you want to have a long-lasting trading career in this business, you have to learn how to use the widely available Fundamental data. You also have to have a simple but effective strategy which allows you to take advantage of the data for profit. You've got to start trading strong and weak Economies and not, just the charts!

Skinny on Fundamentals.

All right, below is the boring stuff that nobody wants to hear simply because many people think that this subject is too complicated, and you need to have Economics degree to understand and trade based on Fundamentals. Don't worry, we're going to simplify the subject and focus on what matters in Fx Markets only. The Fundamentals could be as difficult as you wanted them to be; there is no need for making this subject even more mind blowing as it is on its own. Like I said, **this is the stuff that majority of people are falling asleep over, yet statistically majority of people loose in Fx Markets.** I know; it is hard to wrap your head around some Fundamental concepts. **However, if you internalize these concepts, you will change the way you look at Markets forever.**

There are two sub-types of Fundamental Analysis: Macro & Micro

Macro-Fundamental Analysis - The Top Down Approach.

Macro-Fundamental Analysis centers around broad economic factors that impact the exchange market altogether. The concept of Macro-Fundamental Analysis begins with the overall assessment of the Economy. Then it moves to analyze its effects on sectors, groups and lastly down to specific trading asset class in the industry groups. **The Top-Down Approach focuses on Employment, Inflation rate, Growth Rate as well as numerous mixtures of other Economic activities.**

It is worth noting that investment management companies and large brokerage firms substantially prefer Macro-Fundamental Analysis as their conventional method of approaching the Markets as it provides structure and more organized framework.

Macro events:

Things that move the Fx Market on a **Grand scale.**

Fiscal policies:

These are laws, and regulations set by the government relevant to taxation as well as spending. Fiscal policy's objectives are **price stability, economic growth, maximum employment.** Fiscal policies may also be used to increase or reduce

business activities. Here is an example, let's say the government decides to increase taxation, then consumers would likely have fewer net incomes, which leads to lesser spending on goods and services. Tax policies and regulations are among many tools the government uses to induce or slow down the Economy.

Monetary Policies:

The handling of interest rates and money supply by a Central Bank. In the U.S., it will be the Federal Reserve. Monetary policy is put in place as part of a strategy to keep control over Inflation and achieve currency stability.

Compare to Fiscal policy, Monetary policy is directed more at financial markets, and its effects in changes could be noticeable right away rather than subtle as compared to Fiscal policy. Monetary policy is one of the two practices that the Fed uses to influence supply and demand of Money.

Downgrades:

Downgrades from the top rating agencies such as Fitch Ratings, Standard & Poor's and Moody's can negatively impact on the outlook of the country and its Economy.

Elections:

Elections are always viewed as a cause of Volatility in Fx Markets. It is only natural for the Investors to be more cautious with such events. As long as political uncertainty is in the air and psychological tensions arise, this behavioral pattern will continue to repeat.

Bond Yield Auctions:

Many traders don't realize the importance of Bond Market in relation to Fx Markets. The bond market is a crucial component of the Financial marketplace, as such can and will influence Currency Trends. Bond Market will "price-in" any future changes in Interest Rate's differences between currencies beforehand. It can be used as a leading indicator by Fx speculators. Monetary inflows and outflows in Bonds strongly correlate with currency market and play a major role in developing long-lasting trends.

Central Bank Interventions:

When a state of the Economy abruptly changes or when the Market misconstrues economic indicators, Central Bank uses Interventions to correct the course of the currency and to adjust the Volatility. In most cases, Central Bank will sell its Reserves to correct exchange rates if it feels that the currency is too overpriced, or if it needs to boost the Exports. The reasons for the Interventions may vary from one Economy to another, but the implications, nevertheless, are global.

Micro Fundamental Analysis - The Bottom Up Approach.

The Bottom-Up Approach or better known as Micro-Fundamental Analysis is an examination of certain behaviors and economic patterns that trigger events leading to an Economic activity. For instance, it analyses economic releases, corporate or company actions, social policies, workforce activities and a whole lot more. Simply put Microeconomics tries to forecast Economic trends, which could possibly influence the price of an asset whether it is a stock, bond or a currency in our case.

Micro events:

This is what makes the Fx Market “tick” on a daily basis - Micro events & Geo-Political events.

Economic releases:

On a day-to-day basis, Currency's exchange rate fluctuates because of imbalance in Supply & Demand. Nothing more is so powerful in affecting this imbalance as High-Impact Economic releases. Currencies can move a great amount of distance in a matter of seconds. Checking Economic calendar for the scheduled news events carries an outmost importance for Fx speculators.

News Headlines:

You have to be News literate if you wish to be involved in Fx speculations.

Following News on Bloomberg or Reuters even as a background, will keep you in the loop of any developing global events.

Commentary from Gov. officials:

Rules and regulations, as well as verbiage that is used by Central Banks officials, definitely carry significant weight in the Fx World. Central Bank's minutes and

press releases can bring an enormous volatility and sometimes change the whole outlook on the currency.

Mergers and Acquisitions:

If it is an International event, local currency needs to be exchanged for the relevant one to fund the deal. These events can create inflows or outflows of cash hence temporarily affecting an exchange rate, especially if the Deal is too big to transact in one session.

Option Expirations (monthly and quarterly):

On these dates, Fx Markets will move in unpredictable sometimes erratic ways due to volatility that is being spilled over from currency option's market. Mainly because large option contracts are being defended by option sellers at certain price levels. Just being aware of these option expiries will keep you out of trouble, meaning you would not want to establish new positions on these dates.

Geo-Political events:

The whole array of non-Economic events ranging from wars to natural or man-made disasters, including terrorists' attacks, regime changes, major workers' strikes, elections, and etc.

Conclusion:

As Forex speculators, we should be involved with the Economic decisions and activities of each currency, at least, the ones that we trade. We should be asking ourselves, how these activities impacting the currency? Has the most-recent economic release influenced the value of the currency and by how much? What are the current Monetary policies of the currencies? What are the overall cycles of each currency, Expansion or Recession? What is the Central Bank's view on their currency?

Basic Economic concepts, every Trader should know.

Expansion – Recession.

As the pace of business activity fluctuates, World Economies have always undergo their business cycle's changes. It is a currency trader's job for that matter, to recognize where in the cycle, each Economy around the World is, and to anticipate changes in the economic climate before it is apparent to the masses.

Economic Cycles are broken down into two main categories: expansion and recession. Expansions are corresponding with a strong and growing economy while recessions are defined by a decline in economic activities, which eventually results in suppressed growth.

These economic cycles create “risk-on,” and “risk-off” market environments based on which investors allocate their money. To know where the Money flows, or correct to say in what currencies Money is flowing into, has great importance to us as Fx traders. There are certain currencies to be traded in each Market environment, more on that later.

Expansion:

An economic expansion is a period of economic growth as measured by an increase in GDP as well as a jump in the level of economic activity. When a country's Gross Domestic Product goes up over a specific period of time, it is viewed as, having an economic expansion. An Economic growth takes place either as a natural process or through government interference - stimulation.

Generally, this is how it happens:

To create Demand or to add Money into a financial system, the Fed purchases Treasury bonds in the open market. By doing so, it swaps bonds for cash that investors put in banks. In turn, the financial institutions are more willing to lend out this excess of Money. Low-interest rates, accessibility of loans gives small companies and big corporations an opportunity to increase their business activities. For instance, acquire factories, purchase manufacturing plants and equipment, hire more employees, so they can produce more goods and services.

To create supply, the Fed can change its Reserve requirements or lower Interest

rates, thus taking Money out of the System. Interest rate manipulation is among several tools the Federal Reserve uses in managing the Economic cycles.

Key features of an Expansionary cycle:

- Higher disposable incomes
- Rising employment
- Increased consumer spending
- Household demand rises
- Business production increases
- Rising sales
- Better Wages

Summary:

Consumer + Business, and Gov. Demand rises

Recession:

A Recession is a considerable decline in economic activity commonly defined as a drop in GDP for a couple or more back-to-back quarters. As a result of the Recession, the following areas of the Economy are negatively affected: stock market, housing market, labor market and the list goes on. In this type of environment, cash supply starts to diminish as businesses and customers restrict funding and spending. The lower spending usually results in higher unemployment.

Companies may still show earnings as they sell off inventory, but eventually deteriorating economic climate catches up with them.

Clearly, the Recession is not good, however; it is not as extreme as Depression. Generally, it is considered that if recession lasts long enough, then it might be classified as a Depression.

Key features of a Recession cycle:

- Businesses cut their production
- Workers work less
- Lower disposable incomes

- Companies eventually Fire
- Higher unemployment rates

Summary:

Consumer+ Business, and Gov. Demand declines.

Inflation – Deflation.

Inflation:

Whenever the overall price of products and services rises, it is claimed that Inflation is rising as well. Inflation measures by how much the normal rate of prices on goods and services increases over time period. Rise in inflation is frequently triggered by the oversupply of money, in other words, **when we have too much Money chasing fewer goods**. Central Banks attempt to avoid an extreme increase in inflation, because as the cost of goods and services rises, so does the value and the purchasing power of the currency fall. That means Consumers and Businesses are able to purchase less since the rise. The Inflation rate constantly changes based on circumstances; however In the United States, the Fed makes an effort to keep a certain level of inflation, which is usually 1-2%. Commonly Inflation is assessed by the economic indicators such as **Producer Price Index** and **Consumer Price Index**.

Deflation:

Logically, deflation is the opposite of Inflation it happens when prices of goods and services are falling. When we have a reduction in the supply of money or credit, we have cause for the decline in prices, leading to a possible deflation. Simply put, deflation is when **too little Money is chasing too many goods**. It is also important to mention that deflation is affected by spending or to be exact, the lack of Government, Private sector and Investment spending. At times, deflationary forces can hit the Labor sector fairly hard by increasing unemployment level as the overall demand in the Economy decreases. On the other hand, deflation makes more affordable to struggling consumers items such as food, fuel, and housing.

GDP - Measuring the Economy.

Gross Domestic Product (GDP) is the overall value of the products and services a

country generates in an entire year. Federal Reserve or the Fed utilizes the GDP as their gauge of the Economy. To be more exact, the Fed evaluates the growth of the GDP each quarter and uses as a benchmark of Economic growth. The Fed also uses the growth rate to choose either to apply an **expansionary monetary policy to fight off recession** or **contractionary policy to control Inflation**. Gross Domestic Products is also used as a way of measuring the size of a country's Economy.

The key words here is the "growth rate," which is the percentage increase in the economy's output from quarter to quarter. It evaluates how fast the economy is growing. Now, why is this so important? GDP growth rate is the most relevant indicator of economic health. When the economy is expanding, meaning - jobs, business activity, government spending, personal income increase, it reflects in positive GDP growth rate. Investors compare country growth rates to discover the best venture opportunities. In addition, Investors evaluate the growth rate to determine if the economy is transitioning from one state to another so they can readjust their capital allocation.

Bottom line:

GDP represents the Economy, the four components of GDP to be precise. GDP formula as follows $C+I+G+NE$ where:

C= Consumer consumption - the biggest, percentage-wise, and by far the most crucial component which includes Retail Sales.

I= Investment – business investment: construction, manufacturing and inventory levels.

G= Government spending.

NE= Net exports - this depends if the country is Importer or Exporter.

Balance of Payments.

The Balance of Payments presents the total of trade balance, foreign trade activities, and balance between import-export. Simply put, balance of payments is the track-record of a country's transactions with the rest of the World. The Balance of Payments is considered to be positive when incoming payments exceed outgoing to other countries and economies. The excess is a positive factor for growth and strength of the domestic currency. There are two parts to the Balance of Payments, Current Account, and Financial Account.

The Current account measures a country's trade in capital as well as import-exports of goods and services. Basically, it is a country's net income, trade balance, and direct payments. Current account is in balance when businesses, government,

and consumers have sufficient income and savings to fund business growth, infrastructure spending and purchases in the country. The objective for most countries is to bring more earnings by exporting more goods and services than it imports. When this happens, it creates a surplus in trade balance. Deficit occurs in the opposite, when a country exports fewer goods and services than it imports and also, this is important; it takes less capital from foreign investors than it sends out.

The Financial account measures International ownership of assets. To be exact, the financial account evaluates the change in international ownership of assets. It allows you to find out if the amount of assets held increased or decreased. It must not be mixed up with the current account's income, like dividends and interests, that are earned on these assets. The assets include securities, such as bonds and stocks as well as commodities. The owners can range from individuals up to central banks and the governments.

The financial account further divides into two categories. The domestic ownership of foreign assets and the foreign ownership of domestic assets. When domestic ownership increases, it adds to a country's financial account. In case if the foreign ownership rises, then it subtracts from the financial account.

The importance of financial accounts is due to the fact that it is a large component of balance of payments, and it can offset a trade deficit when it has a significant enough excess.

Trade & Capital Flows in relation to FX Market.

Trading services and goods between countries constitutes Trade flows. There are countries that are net exporters, for instance, Japan, China and net importers like the USA and the Great Britain. Naturally, exporters trade more to international clients than they import from international producers. Understand this, when worldwide clients must buy exporter country's products and services, they must transact in that country's currency; they need to exchange their money for the other. This process creates demand for that country's currency as cash flow is being injected regularly. Good example of this was the Japanese currency in late 2003, when despite the economic weakness, it's value appreciated because of very strong exports. For the countries that are net importers, as they import more from international producers, the currency depreciation would be the case. In order to purchase international goods importer have to sell its domestic currency and buy a foreign one. Please note that a country might be a net importer in one area, but

be a net exporter in others.

Example:

The UK imports mostly finished manufactured goods but export basic materials, food, beverages, financial services and business services.

Bottom line: trade in goods and services is the largest component of the above-mentioned Current Account. For that reason, a trade deficit is usually enough to create a current account deficit which occurs when a country imports more goods and services than it exports.

Capital flows distinguish money sent from overseas investors as they allocate their capital in foreign Markets. **A country might have either a positive or negative capital flow.** A positive capital flow means that investments from foreign sources exceed that country's cash outflows into other economies. More money comes in instead of leaving. Investors have to change their money for the currency of the country they invest into. As more money comes in, it creates demand for that country's currency. More demand means more value. The opposite is true for the negative capital flow. When a country has a negative capital flow, it causes to lose value of their currency. As demand for the currency decreases so does the value. Countries that experience economic growth, especially growth in financial market; offering high-interest rates on their financial assets, tend to attract a majority of foreign investors. As the foreign investments flow into the country, demand for the currency increases as well as the valuation.

Budget Deficits.

Nowadays, it is a common exercise for Governments to operate with a deficit.

Anytime the taxes collected aren't adequate to satisfy Annual Budget, the practice of borrowing funds becomes the usual norm.

Just what this signifies, is the undeniable fact that nationwide government is functioning with a shortage. It spends a complete lot more than it collects from taxes or any other kinds of revenue.

Eventually this leads to downgrades from top rating agencies, resulting in higher interest payments and whole other issues. In case the interest payments become high enough, it eventually creates a drag on economic development, as those finances could have been applied to stimulate the economy in a first place. If Debt is mostly owned by domestic investors, then it will certainly reflect negatively on

Consumers by increasing their cost of Living. As each year, the deficit is added to the public debt it slowly and methodically weakens the economy.

There are numerous reasons that a budget deficit doesn't always induce a complete catastrophe. For one, it is not an indication of an Economic Health. For the second, numerous countries, including the United States, are in a position to “print” their own currency. That means when debt needs to be paid, they simply create more credit and cover it. For the third, debt can and in most cases is being rolled over.

Budget deficits are definitely not an attractive practice, at all, if you’re catching my sarcasm, however, it is not “The End of the World.” Countries are able to run budget deficits for long periods of time without having an impact on a currency.

Conclusion:

For us, as currency traders what Fundamental Analysis offers is the identification of under-priced and over-priced currencies relative to their future values (Intrinsic Values) by comparing their present state to the Economic background. For this matter, being familiar with the basics of Economic concepts are vital to our success.

Global Market FLOWS and Important Trading concepts.

Probably the most challenging mission of a currency speculator is to investigate Global Economies. Why do we need that? - you may ask, to establish strong and weak currencies in order to deal them against each other. In Fx Markets, money can be made in two ways. **Money can be made on Interest Rates differentials and Exchange Rates fluctuations.** **Buying, or funding high-interest rate currency with lower interest gives you ability to profit from Interest Rate difference.** This is a long-term strategy called “**carry trade**” and falls into Fixed Income Investment category in contrast to short-term Exchange Rates speculations. **This type of strategy is very popular among commercial Banks and Investment firms as their trading capital is immense;** so when you get paid on daily rollovers on a high yielding currencies, it can be quite sizable.

Try to understand this, when you trade at that level, you’re not interested in getting few pips here and there, your focus shifts to longer perspectives, longer time horizons. This is the psychology of these **big fund managers;** they’re looking for high-yielding currencies; they’re looking for growing Economies; it is all about the Yields.

Strong Economies have a tendency to attract fund managers to invest in their currencies or at least “park” their capital to keep it safe. This, in turn, creates demand for those currencies. Strong Economies that are in Expansionary cycles usually have higher Interest Rates, which means that their currencies offer higher returns for their Investors.

Grading the Currencies in “risk-on & risk-off” environments.

Risk-on risk-off environment occurs when Investment actions change in reaction to shifts in Global Economics. For example, when we have risky environment Investors tend to put their cash in lower risk portfolios such as U.S. Treasuries, and low-risk Currencies. On the contrary, when low-risk environment is present, Market Players are willing to take on risky investments such as Food & Energy Commodities, Stocks, and high-risk Currencies. Consider this, Investors are prepared to take on extra risk when everything is “peachy,” but put some stormy clouds and everybody gets defensive.

When the World Economies are going through the cycles, so does the Investors

sentiment is going through the changes. In the case of the Economic downturn, Fx Market participants relocate their investments away from risky assets to the safest ones. Exactly the same is true when it comes to the opposite scenario. What this implies, is that there are few currencies perceived as safe bets and the others as risky.

USD, CHF, and JPY are generally considered to be “safe-haven” currencies or risk-off bets. The United States is in the exceptionally unique position because the dollar is “King” - the dollar is a global currency.

More than 25 countries peg their currencies to the Dollar. Majority of International transactions, roughly about 86% involve the dollar, which means; the United States can operate at a larger debt than any other country. I’m not saying that this is all right by any means. However, this fact makes its economy more stable; reinforcing the dollar's status on a Global arena as a reserve currency in times of economic turmoil.

Side-Note: One can argue about the CHF being the safe heaven, after the “Black Swan” event in January of 2015-th, and negative interest rates. However, an Economic landscape might change in the future bringing the Swiss Frank back it’s favor.

On the other hand, AUD, NZD, EUR, GBP, CAD are considered to be risk appetite currencies or “risk-on” bets.

Now, when assessing the Global situation, meaning; when trying to figure it out what situation we are currently in - “risk-on” or “risk-off” also, please factor in the particulars of each Economy. For example, we might be in “risk off” situation Globally, hence the following currencies should appreciate: USD, CHF, and JPY. However, if Japanese Central Bank is en route to do next round of Quantitative Easing or perform an Intervention, it will weaken the currency for quite some time.

One of the indicators that are well-known and used by professionals for measuring the "risk on - risk off" environment is the VIX.

The VIX measures US Market Volatility in real time and is utilized as a proxy to identify the “Fear level.” It measures the level of Financial stress and also is highly correlated with Bond Market. Low VIX readings below 20 mean No Fear, above 20 readings – Fear. Since the VIX is taken from options prices of the US Equity Market, particularly of the S&P 500 index, it is considered to be a broader indicator.

Conclusion:

Being aware of, and most importantly understanding what environment particular currency is surrounded with gives us an additional edge when making a Trading decision.

Although the fact that the information above might seem simple and concise, it actually covers a lot of the core concepts that are essential for currency traders.

Where do we find the Fundamental information? How do we sort out the data? How do we come as a conclusion on what to trade? These are the topics that we cover in the next chapters.

Currencies and Bonds.

What are bonds?

Bonds are cash marketplace obligation securities, simply put - debt instruments, which can be used by governing bodies and corporations as a way of accessing cheap borrowed financial resources. Bonds are generally supplied by governments at Federal, State, and Municipal levels. Every time they need to raise money, they issue nice and crisp "I-Owe-You's."

Bonds go by different brands and categories; they're also known as **Treasuries**, **T-Bills**, and **Government Notes**. Bond purchasers are paid periodic, typically every six months interests for their investments. Bonds also have different maturity times that can range from as low as 30-days and up to 30-years. **Bonds provide a source of cheaper borrowing in comparison to bank loans, essentially making them very desirable**. Furthermore, bond issuer normally sets the terms of borrowing and financing, which gives the borrowing party (the issuer) the ability to set repayment rates at its convenience. It is then up to the lender (the buyer) to determine if the borrowing terms, interests and repayment percentages are worthwhile.

Bond Prices vs. Bond Yields:

These terms are employed interchangeably a lot when discussing bonds, so it is important to spell out what they are to eradicate confusion. The **bond price is the cost of the bond; that is what the bond buyer pays when buying the security**. The bond yield, on the other hand, is the interest that the bond-holder is given by the bond-issuer for the employment of his or her money.

It is important to remember, that the **bond prices are negatively correlated with their yields**, meaning; when one goes up, the other goes down; bond prices rise – yields go down, and vice versa.

Let's discuss now the relationship between Bonds and Forex, and particularly how two specific properties of bonds influence the value of a currency. We're going to talk about the Bond Yields and the Bond Spreads.

Bond Yields and Currencies:

Bonds are in comparison to currencies a lower yielding opportunities but are considered to be safer assets due to the fact that interest yields on the bond instruments are almost always fully guaranteed. For that reason, Institutions mostly buy bonds if there are some serious concerns in various markets. Which means that, bond-buying is associated with “risk-off” situation. Anytime “risk-off” is present in Global markets, the negative relationship between bond prices and bond yields starts to develop; the prices of bonds start to rise (Demand), which makes the yields to drop.

The safe-haven government bonds consist of The US Treasuries, The UK Gilts and the German Bund. In circumstances when Investors become overanxious about exactly where to put their funds, they simply park or should I say trust their money to safe governments with the understanding that they will receive their money back and also a yield. This is the same principle as buying safe currencies. There is a correlation between declining bond yields, representing increased demand for bonds and demand for safe currencies.

If there is a risk of dreadful Inflation, it creates a possibility of interest rate hikes; this in turn, directs to higher bond yields. Higher bond yields in most cases will lead to a future demand for the local currency. As we mentioned before, when foreign investors exchange their cash for the local currency in order to buy the bonds of that country, it will contribute to an increase in the valuation of the currency. This all leads to a conclusion that rising yield of the bond might result in a higher currency value in the future, if supported by a demand; subsequently, declining yields will lead to a currency depreciation.

We must clearly understand and differentiate the reasons for government bond demand. These include; bonds being perceived as safe haven instruments in times of turmoil, and/or interest rate increase expectation.

The national currency and, in particular, its bond prices are inevitably linked with the country’s interest rate which in fact functions as the gauge for the bond yield. **A common example of how a currency pertains to a bond could be the relationship (positive correlation) involving the US Dollar and the 10-year Treasury Note.**

Bond Spreads and Currencies:

Bond spreads what are they? Bond spreads actually refer to the variance in the bond yields of two countries in comparison. This is the overall foundation of the previously mentioned “carry trade.”

Bond Spreads are considered to be a leading indicator of currency pair future price direction. Typically it is considered, when a 5Y or 10Y yield spreads widen in favor of a certain currency, that currency tends to appreciate against other peers. Nevertheless, we must remember; currency movements are affected by the shifts in Supply-Demand equilibrium, economic assessment or future plans by a Central Bank to raise or lower interest rates.

Now, by implementing this information, it is possible for traders to identify currency pairs where there is a sufficient interest rate difference, and trade them against each other. Therefore, it is possible to profit from bond spreads because the spreads will give us clues about which currency in the future, in the future, is going to appreciate or depreciate in value.

Typically, the greatest profits are produced where a currency with a comparatively high bond yield is traded against another currency which has the lowest yield. Aside from the daily rollover paid out for carrying a long position, hence the name - "carry trade," on a high yielding currency; Fx speculators are motivated to hold such positions for days or weeks in times when the trend favors the higher yielding currency. As I've mentioned earlier in the book, this requires very large capital, and most importantly a "risk-on" environment.

Conclusion:

The Treasuries market truly is one of the most significant, as well as more established when compared to currencies market. Bond yields have a strong correlation with world stock markets, commodities and currencies. The yield spreads become wider or tighter based on a number of factors; most notably - supply and demand, credit worthiness of an issuer, and the overall state of the economy. **In times of global hardship the desire for High grade Investment Bonds increases pushing bond prices higher and the yields lower.** Therefore, traders who observe the Bond market and Bond spreads can have a fairly good understanding of overall forces that influence the financial markets.

Macro Trading.

The Why?

Most retail traders I've come across use some sort of Day-trading strategies that rely either purely on Technicals or trade Micro releases may be the combination of both. These types of traders look like guerrilla fighters that practice hit and run tactics, with "whatever-we-can-grab" mentality. **The really tricky part of this is; the Market definitely will pay you off sometimes and the other, will take away most if not your entire winnings.**

Now, I do not wish to bash anyone or criticize other types of Trading, there are numerous approaches to "skim" the Market. When done correctly, short-term trading undoubtedly can yield some serious returns in a brief period of time. It requires you to be an expert in tools such as **Market Profile; Market Footprints; Market Deltas; Volume Analysis**. You also have to know how to read **Order Flow** and be familiar with Auction Theory. And even then, you still need **Fundamental structure** to overlay on these tools because if you're focused only on immediate things, you most definitely going to miss the "Big picture."

The impact of Macro events, depending on their magnitude and extent will move the markets in a big way overriding the short-term price change. These events also have the ability to change the fundamental opinion of a currency for weeks or even months. For that reason, being on top of Global events, preparing for Macro Fundamental shifts and foreseeing the direction of the Market based on data changes, can be extremely rewarding for Fx traders.

In my opinion, day-to-day Micro activity in Fx market is more chaotic and volatile. The influences of the Macro Fundamentals though are more organized, methodical and prolonged.

Organized, because as group Macro traders - (CTA's, CFA's and CMT's) that are employed by private banks and investment firms, are looking at the same Fundamental reports that are being prepared by well-paid PhD economists who are tracking the same Micro events and pretty much using the same quant-models to arrive at the same conclusions in these reports, wow, that was a mouth-full, but you get the point.

Methodical, because capital allocation happens on the basis of the above-

mentioned reports in millions and billions.

Prolonged, because the Macro Fundamental events have long-lasting effects on Markets. Macro trends do not stop & reverse, immediately. It takes time to unwind Trending positions.

One can assume that Macro trading is no different than Trend trading. In actuality, it differs. **Macro trading entails trading the Fundamental events; your decision-making process is being derived from Macro events.** In the case of a Trend trading majority of decisions are based on Technicals: moving averages, trendlines, specific chart patterns or waves for that matter. Another point is when Trend trading you hardly ever catch the beginning of a Trend if you rely solely on Technicals. The beginning of a Trend is visible on charts only in hindsight. By following leading economic indicators, Macro traders, on the other hand, are reacting or “pricing-in” future economic developments in “the now.” **In essence, Macro-Fundamental trading is somewhat leading rather than lagging.**

The Who?

We answered the Why, yet another logical question arises as we’ve heard it so many times, “...don’t follow the herd!” - who to follow then?

Out of various Market participants ranging from Institutions, Pension Funds, Corporations, and etc.; who do you think has the most influence in the currency markets?

Without the shadow of a doubt, it’s the Central Banks – “The Guardians of the Currencies.”

Pay attention to what the Central Bank is focusing on and anticipate its next move, whether it’s an Interest Rate hike/cut or other changes in Monetary policy.

The four major areas of focus of a Central Bank are:

Inflation

Employment

Growth

Production

When something needs to be influenced, fixed or adjusted in the Economy, Central Bank uses tools at its disposal:

Interest Rates – raising or cutting Interest Rates to control Inflation and supply of Money.

Reserve Requirement – increase or decrease of reserve requirements for banks to restrict or to boost lending, again to control the supply of Money.

Open Market Operation – selling and buying of Gov. Bonds to control supply and demand of Money.

Price Limit – the boundary, “the floor” or “the ceiling,” consider them support or resistance that Central Banks are defending.

Verbiage – usually serves as a preliminary to something stronger: an action, condition or an event. Very important to follow, and read summaries by various analysts to decipher their intentions.

Interventions – The buying or selling of domestic or foreign currency with intent to manipulate certain Market conditions or exchange rates flows.

Quantitative Easing – printing of Money to boost the supply, weakens the currency. QE is perceived by many economists as a non-conventional tool of Monetary policy.

We as Retail Traders will comprehend Central Bank’s activities much better, by understanding its framework and its logic. It’s logic is defined by the major areas in focus, especially the Inflation. Central Bank analyses Macro economic data as well as Micro data and measures the overall health of the Economy.

Remember this; Central Bank sets the Market Sentiment for the currency at each meeting. Following their press releases, meetings and paying attention to their Market commentaries will give us clues on what is their focus on and what to expect.

I agree, sometimes Central Bank’s view on the currency is clear as day light, other times it might be vague and pointless. Nevertheless, whatever Central Bank does or does-not, be sure that it has a reason for every single move it makes. The difficult part here is to decipher it’s intentions. Now, by knowing their major areas in focus and tools they use, this process should become less painful. **Basically, we’re going to put our Central Bankers “hats” on and trade inline with them. Compare this type of trading to navigating the Icie North Sea; imagine yourself as a small barge following mighty ice-breaker.**

Conclusion:

Choosing Macro trading style and particularly adopting the Central Banks framework gives us an additional edge to our already advantageous position. Consider this, if the private banks and Institutional traders are “eyeballing” the

Central Banks, it should be good enough reason for us to do the same.

The How?

Below I've listed my daily step-by-step processes, my practical applications, and daily trading routine, that I live by.

You're more than welcome to use the same processes or create your own signature trading routines. In this section, I also reveal tools and resources I personally use, some of them are free and the others are paid. Choose what is best for you. I'm in no shape or form associated with them. Now, the way I reveal my steps is as follows: I describe the step, the reason and the logic.

The Routine:

1) Check Your Charts - Watch the Price Action

I consider myself a Fundamental trader, but I am also a Technical analyst, so I open my charts first before the start of a trading day and check for recent price action. I'm looking for the moves that might have happened without me, see what has moved and by how far. I use the one-hour and four-hour charts. I also use Daily, Weekly and Monthly charts, but these timeframes are for my longer-term assessments. Note that one-hour is my smallest timeframe, anything less than that, and you're stepping into the Market Makers domain where intraday volatility and speed reign the day.

2) Do the Research - Find the reasons "Why" the currency is moving

If any of the currency pairs moved more than its Daily Range, for that I use ATR(Average True Range) or ADR (Average Daily Range) indicators, within one trading session, I start researching the Fundamental reasons and "why's".

You may use the resources below:

Forex Live – www.forexlive.com (Free - realtime filtered news & analysis, excellent for Daily sessions, always up to speed.)

Talking Forex – www.talking-forex.com (Paid service – It's live; no delay, good source of professional research reports and Market rundowns, it cost £20 per month and uses the same feed as Ransquawk.)

FxWirePro – www.fxwirepro.com (Paid service - wide range of Financial information ranging from Fx Newswire up to Top Banks researches, Trading ideas and more.)

If there were no distinguished movements in the Markets - "business as usual" so

to speak, I switch myself into a “Hunting-Mode.” I go to Bloomberg’s site, specifically into Markets section to find trading ideas from their Daily reports. **Bloomberg’s reports are a fantastic source of Fundamental information from which you can formulate trading ideas.**

Here is the link: www.bloomberg.com/markets (Free - Bloomberg news & reports)

Now, when analyzing the reports there have to be four things they cover, if not I consider the report to be non-tradable. I’m utilizing the “C.C.R.P.” approach, where: C - stands for currency; C – course; R – reason; P - projection.

Let me explain this in details:

C.) - Currency in the spotlight.

C.) - Course, is it weakening or getting stronger.

R.) - Reasons, preferably the Macro-reasons for the future or the immediate move; what caused or will cause the move specifically.

P.) - Projections, analysts’ further expectations, where the currency is headed next.

If one of the four ingredients is missing, I simply disregard the report. This is **how Institutional and Bank traders speculate in the Markets**. They have economic reports and Market rundowns prepared for them by highly educated and a well paid group of analysts. These reports get passed on to them pretty much with the same core points as described above.

Note: You may use multiple sources for the step #2 - “The Research,” however, you must have these four points as checkmarks at all times, to remove any unclarity from your decisions.

Example:

Pound Weakens as Factory Output Drop Adds to Dovish BOE Outlook

December 8, 2015 — 1:45 PM GETUpdated on December 8, 2015 — 3:15 PM GET

- Manufacturing production dropped 0.4 percent in October
- Pound falls versus most major peers before BOE meets Dec. 10
 - **The pound dropped for a third day against the dollar after a report showed U.K. factory output fell more than economists forecast in October, while industrial production barely grew.**
 - **The U.K. currency weakened against most of its major peers, falling for**

the first time in three days against the euro, as the data added to the reasons the Bank of England may hold off raising interest rates.

- Central bank Governor Mark Carney first said in July that the timing of when to tighten will become clearer around the turn of the year. Since then officials cut growth and inflation forecasts while highlighting the drag to price growth by the strength of the pound as evidence to support keeping rates on hold. BOE officials will announce their latest policy decision on Dec. 10.
- “It doesn’t feel like we are any closer to that rate hike now than we were in August, that is on the back of weaker data, which is at least in part a function of sterling’s strength,” said Jane Foley, a senior currency strategist at Rabobank International in London. “There was that soft patch in manufacturing during the summer, it seemed to improve and now it’s fizzled out again. Sterling has done some monetary tightening already, it suggests the BOE need not be in any rush to hike rates.”
- The pound fell 0.3 percent to \$1.5004 at 11:11 a.m. London time, having declined 0.6 percent in the previous two days. The currency slid 0.4 percent to 72.28 pence per euro.
- Even after Tuesday’s decline, the pound has still strengthened against the majority of its Group-of-10 peers this quarter. The BOE has kept interest rates at a record-low 0.5 percent since March 2009.

Trimmed Forecasts

- Manufacturing production dropped 0.4 percent, after climbing a revised 0.9 percent in September, the Office for National Statistics in London said. The median forecast of economists in a Bloomberg survey was for a 0.2 percent decline. Total industrial production rose 0.1 percent, the ONS said.
- When the central bank trimmed its forecasts for growth and inflation in the November Inflation Report, it also suggested risks from emerging markets had intensified. Consumer prices in the U.K. fell an annual 0.1 percent in October. The central bank targets growth of 2 percent.
- The five-year break-even rate, a gauge of market inflation expectations derived from the yield difference between U.K. government bonds and index-linked securities, fell to the lowest level in more than three months on Monday.

- U.K. government bonds fell as the nation sold 2 billion pounds of 30-year gilts. The securities were sold with an average yield of 2.49 percent, the highest since July.
- Ten-year yields rose four basis points, or 0.04 percentage point, to 1.84 percent. The price on the 2 percent security due in September 2025 fell 0.375, or 3.75 pounds per 1,000-pound face amount, to 101.38.
- “We expect the pound to remain subject to downside risk, especially as the BOE may reiterate the more dovish message of the latest inflation report,” Credit Agricole SA’s strategists, led by Valentin Marinov, head of Group-of-10 currency research at the bank’s corporate and investment-banking unit in London, wrote in a note to clients. Medium-term inflation expectations “have been falling of late, mainly in reaction to weakening investors’ U.K. growth expectations.”

Source: [Bloomberg.com](https://www.bloomberg.com)

As we can see from the report I highlighted all four topics they've covered from my list:

C.) We have the currency in the spotlight - the Pound.

C.) We have the Course – it is weakening.

R.) We have the Reasons – Fundamental reasons: factory output fell (No demand); Industrial production didn’t grow (No Economic growth); Inflation is low (If Inflation is low, there is No need to raise Interest Rates. No higher Rates - No Capital Inflows); Investors’ expectations of U.K. growth is low. (Pessimistic outlook – No Capital Inflows).

P.) And finally the Projections – pound is subject to downside risk, even though it didn’t say the exact targets, it was still ok.

Probably the biggest clue for me was the part in “Trimmed Forcasts” section; I’ve highlited in green.

- “U.K. government bonds fell as the nation sold 2 billion pounds of 30-year gilts. The securities were sold with an average yield of 2.49 percent, the highest since July.”
- “Ten-year yields rose four basis points, or 0.04 percentage point, to 1.84 percent. The price on the 2 percent security due in September 2025 fell 0.375, or 3.75 pounds per 1,000-pound face amount, to 101.38.”

Source: Bloomberg.com

Here is my train of thoughts at that time:

(The 30-year gilts are considered among the safest Bonds on the Market.

Bond prices are also affected by Supply and Demand forces.

Both, the 30-year and the 10-year bonds fell in price.

Clearly the Bond Market was “pricing-in” the future direction of GBP ahead of the Interest Rate announcement. One thing was left, to see if the Supply from the Bond Market would’ve spilled-over in the Currencies Market.)

Now, what this report did for me? It gave me enough information to consider the British Pound for the sell-side only, for the time being. The report enabled me to formulate a possible trading decision based on Fundamental information. I had a Fundamental framework to work with; I could match the weaker Pound, against the obvious choice at that time the strong Dollar, and that is powerful my friends.

Note: You can start from the “Research” first and then move to “Charts,” it is totally up to you.

3) Check the Macro

Find out how the Move or the Bloomberg’s report lines up with Macro Fundamentals. Find out how the recent activity is inline with Central Bank’s outlook on the currency. What is their current Monetary Policy? Read the reports of different analysts, gather information. **You need to “roll up your sleeves” and start investigating.**

Here are the resources:

ActionForex – www.actionforex.com (Go to “Analysis” section, there you find an aggregate list of Weekly and Daily Fundamental reports prepared by various Private Banks, Brokerage Firms and Financial Institutions. If you click on “Action Insight” tab, you’ll find “Market Overview” and “Special Reports” written by Action Forex in-house analysts. The whole site is an excellent resource not only for Macro’s but as well as for the “Research” part of your processes.)

Central Bank News – www.centralbanknews.info

(Massive site, everything about the Central Banks and their Policies.)

For a quick reference, below are the links to eight major Banks. You can go straight to the source.

North America:

www.federalreserve.gov

www.bankofcanada.ca

Europe:

www.ecb.europa.eu

www.bankofengland.co.uk

www.snb.ch

Asia - Pacific

www.boj.or.jp (use Google-browser to translate it)

www.rba.gov.au

www.rbnz.govt.nz

To research previously mentioned areas that Central Banks are focusing on, or if you would like to dive-in to every nitty-gritty of fundamentals, you may use the following resources:

www.tradingeconomics.com

www.oecd.org

Here are the resources for Bonds:

<http://www.investing.com/rates-bonds>

<http://markets.ft.com/research/Markets/Bonds>

4) Check the Micro

Check for scheduled economic releases as they create Order Flows in either direction. If you carry an open position into the release, it will be affected.

If you have a sizable profit from previously opened position, going into the release, think whether the risk of leaving it worth the shot. **Most traders are booking their profits about an hour or 30 minutes before the Major news releases. Stick to this rule too, unless you're certain that the move will be in your favor.**

Remember, any movement created by Micro release that is not inline with Macro Fundamentals will be short-lived. The overall Macro Trend will always prevail as there is an enormous amount of Institutional Money Flows involved in Long-term Trends.

Below is the list of **Economic Calendars** I use. In times of the releases, I actually use both in the order they are depicted:

WorldBusinessPress – www.wbponline.com (My “go-to” calendar, releases come out in a speedy manner, more transparent info, includes accurate Revisions.)

ForexFactory – www.forexfactory.com (One of the oldest free economic calendars, good for Historical data, however, very slow at times of releases.)

Despite the fact that economic releases are color coded according to its importance, nevertheless **I’ve listed the most important of them:**

1. Central Bank’s meetings
2. Interest Rate announcements
3. Inflation reports
4. Employment
5. Retail Sales
6. Consumer Confidence
7. Housing Data
8. ISM/PMI reports
9. GDP
10. Trade Balance
11. Balance of Payments
12. Commodity prices, Energy, Precious metals – (for AUD and CAD economies)

For Options Expirations you may use:

www.marketwatch.com/optionscenter/calendar

Note: Having Bloomberg-TV or Reuters on, even as a background will keep you informed of any News Headlines or Geopolitical developments around the World.

5) Get the Entry

This is the Time when Technical traders can shine. If the Technical Analysis is your forte, you will find the entries pretty much easy if not, then read on.

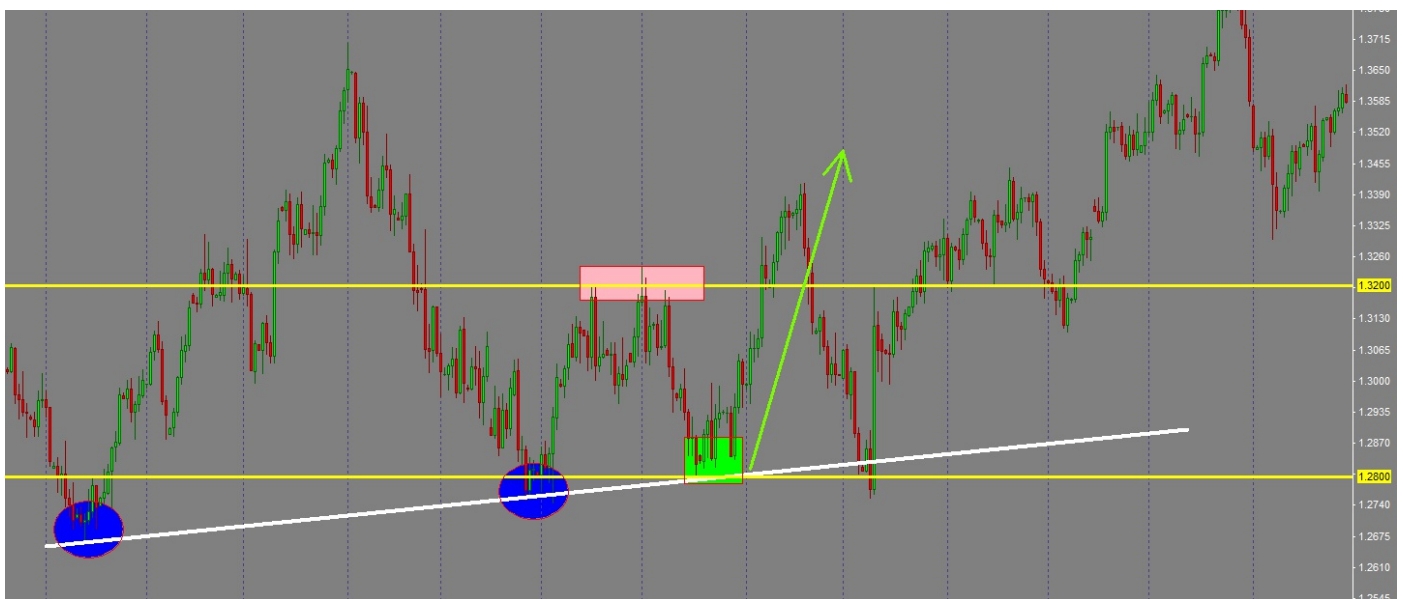
Look for Technical Levels where the Market was “sold-off” or “bought-off”.

These Levels are Supply and Demand zones; they are good places to either, put resting (limit) orders or use market orders to engage the trade. Note please, that

there is a difference between **Supply & Demand zones** and **Support & Resistance**. As by definition it speaks for itself, Supply & Demand is a zone; it can be as wide as 50 pips and as narrow as 10, while Support & Resistance is a line or several lines across the chart. Zone can encompass several Support & Resistance lines, thus making it much stronger to “lean on” when looking for places to buy or sell. Supply & Demand zones are also very good areas for stop placements. Depending on direction, I place my stops below or above these areas, and far enough to avoid “stop-hunts.” I use horizontal Supply & Demand zones as well as diagonal commonly known as Trend Lines. Both these technical tools offer good areas to engage the Market, especially when they come together on charts.

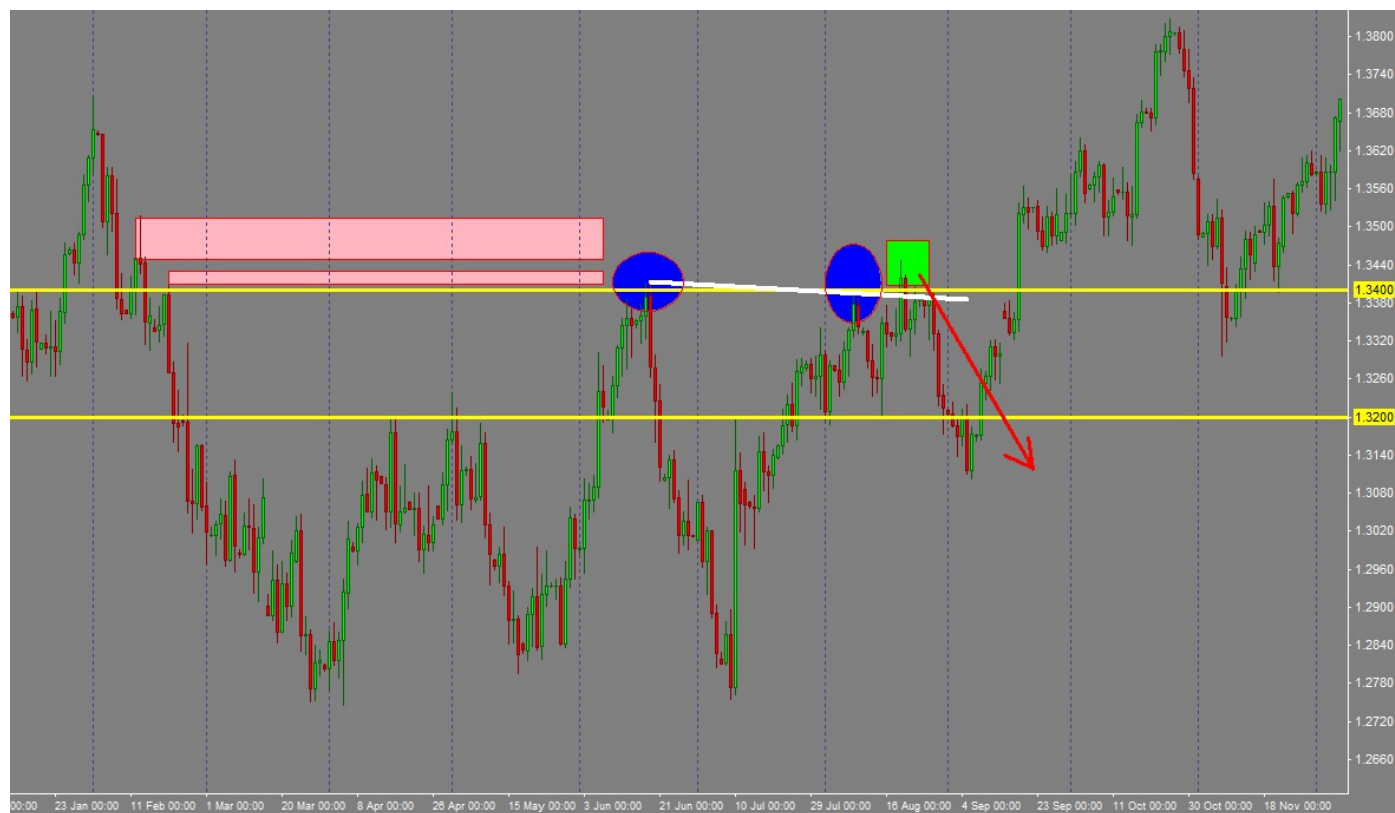
I also pay attention to ‘00’ price levels, mainly because traders watch and are concerned about these levels. You see, we as human beings like simplicity; and often than not, we use this price points when placing our stops or limit orders. Oftentimes, round numbers such as ‘00’ will attract more attention, and appoint a higher degree of strength to such periods. In many ways, these “emotional” levels can be looked at as turning points; areas where there may be some aspect of support or resistance, however, it is impossible to tell whether the levels will hold or deflect the price until after the fact. Traders can make use of these levels, especially when prices have been resisted or supported there in the past. This informs the trader that others are recognizing and acting on those values.

Example Long:



EUR/USD Daily chart. The dark blue circles are the two points that gave me permission to put across the white trend line. The yellow horizontal lines are the round ‘00’ numbers. The light green square box is the possible (demand) Entry area, and the pink box is the (supply) Exit area. Note how the yellow 1.2800 round number held the price 3 times (from the second blue circle, to the right) validating the “round numbers” concept.

Example Short:



EUR/USD Daily chart. Like in the previous example all the glossary meanings are the same.

Note: As we can see from the Examples, in both cases the Stops of 100 points would've been sufficient enough for initializing the positions. Reward-to-risk ratio in "Long" example would've been a minimum of 3:1; and in the "Short" example – 2:1.

The Logic behind every Entry.

When you enter a trade at a specific price, ask yourself - are you getting any value? Anyone can participate in a Trade by simply paying the price, but not everybody is getting the value. Every time you're opening a position you should be asking yourself, "- am I getting any value"?

There is a Fundamental Value and a Market (present) Value. Fundamental Value is an "Intrinsic Value" of a currency; it is projected value based on Fundamental calculations. Market Value and Market Sentiment are the same things. Market Sentiment is the "Mood" of the Market. Market Sentiment can "change on a dime." For example, we might have a high-impact economic release that just came out, and the numbers were great; this should create positive response from the Market participants. However, if the overall Fundamental Framework has not

changed, as it takes a bunch of high-impact releases to change the outlook, then **the move will be short-lived**. Most probably the Market will correct the price action in the following trading sessions. Sometimes, it takes a little longer to develop the adjustment.

The bigger is the divergence between actual price and the Intrinsic Value, the greater the chance of price adjusting back to its value.

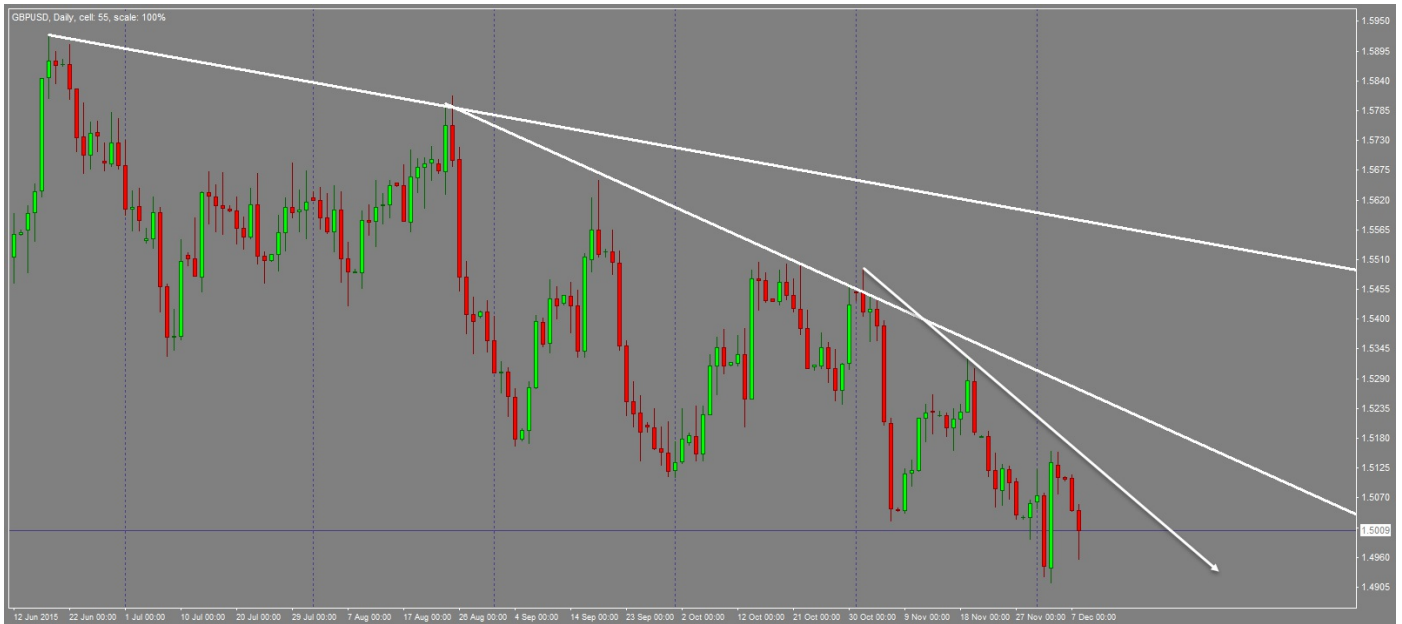
Think about this, what you see on a chart is a Market Sentiment or an advertised price. At times, Market Sentiment will be inline with Fundamental Value, but most of the time it will be overvalued or undervalued, simply because different Market participants have their own perceptions of value.

That is why for us as currencies' traders it is so important to be aware of the Intrinsic Value and check if the current Market price is undervalued or overvalued. By doing so we are able to find good Entry points, after all, it's always advantageous to buy when something is Oversold and to sell when Overbought. If a currency is trading at a much higher premium from the "book value," you know it is overpriced, and if it is at a lower premium, then it is underpriced.

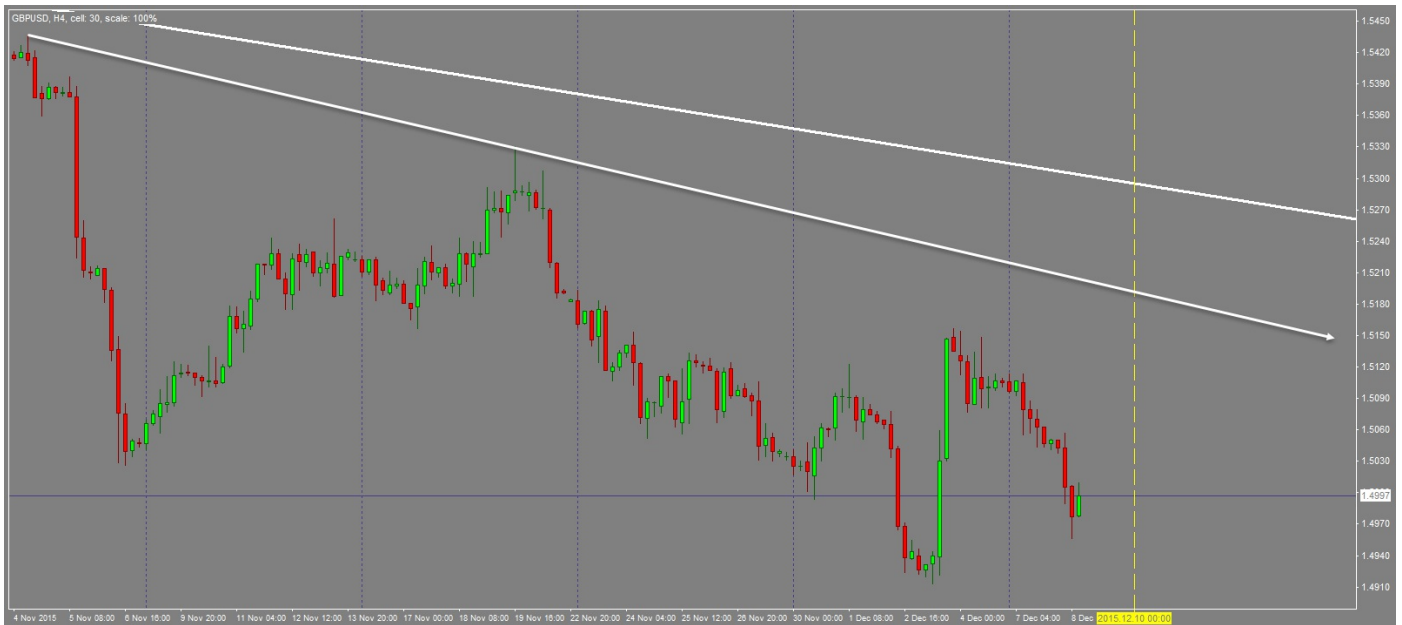
Side-Note: Finding the Intrinsic Value has nothing to do with Purchasing Power Parity (PPP). Purchasing power parity is a theory which states that exchange rates between currencies have to be in equilibrium when their purchasing power is the same. However, the Purchasing Power Parity is not always an accurate measurement of Overbought or Oversold state of the currency. Currency can stay Overvalued or Undervalued for long periods of time in relation to PPP. It used more as a benchmark rather than as an accurate measure.

In regard to PPP, the value of a currency depends on Investors' perceptions of that value. Perceptions and where the Investors allocate their capital depends on Intrinsic Value.

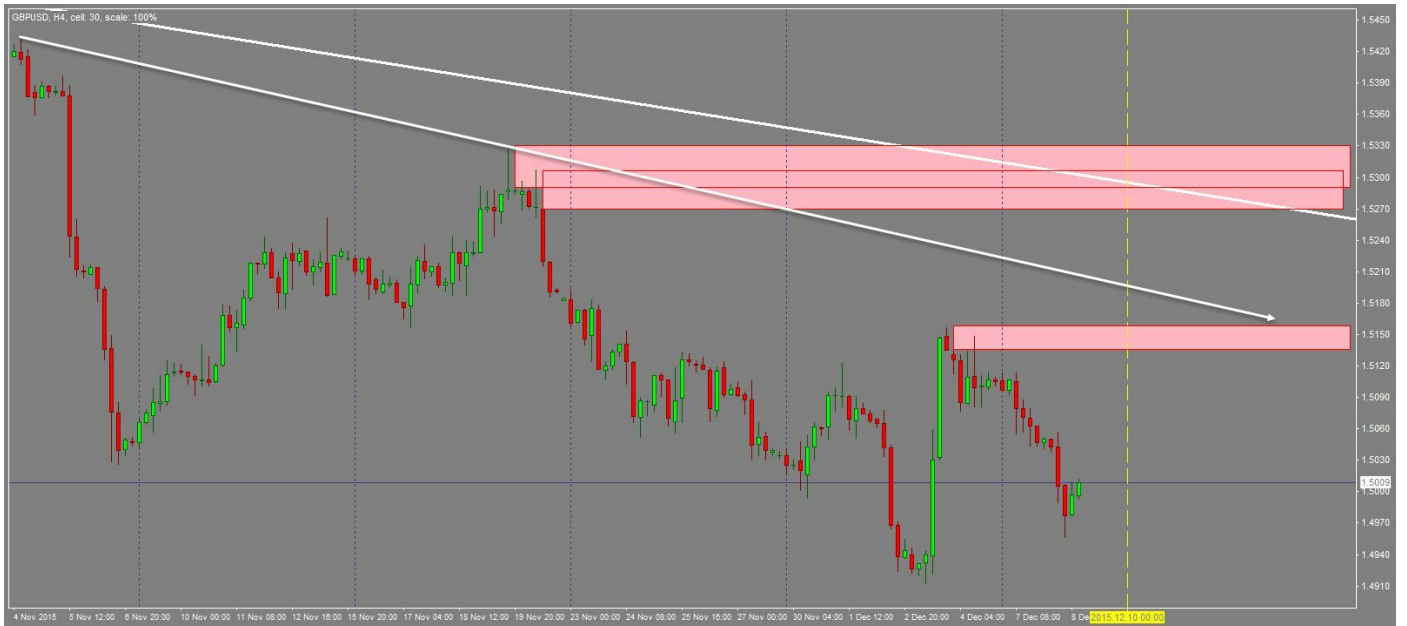
Lets go back to our previously mentioned Bloomberg's report (from step #2 "the Research") on British Pound and illustrate an **Example** on how Fundamentals can be combined with Technicals:



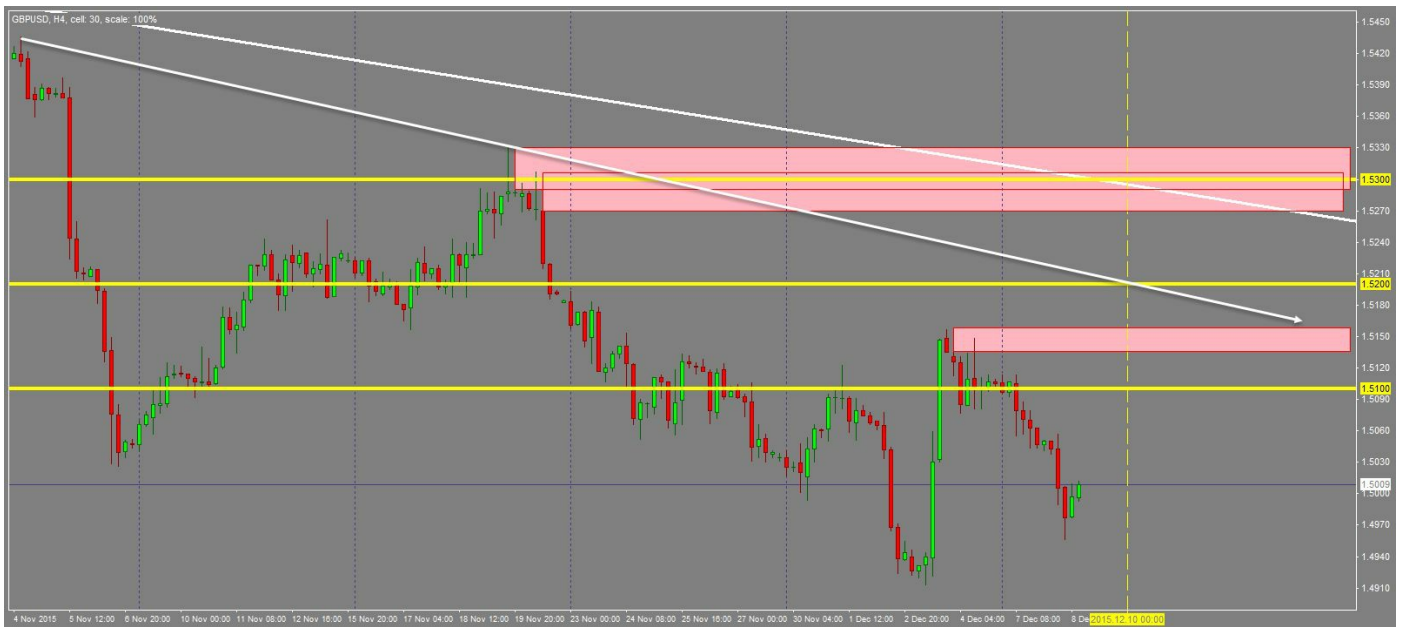
GBP/USD pair- Daily chart. This is how the Pound looked on Daily chart 2 days before the Interest Rate decision, scheduled on December the 10-th of 2015. As we can see it is in clear technical Down Trend as defined by the Trend lines.



The same GBP/USD pair only on 4-Hour chart. I have marked the Event with yellow, dashed, vertical line.



GBP/USD 4-Hour chart with pink rectangle areas representing the Supply zones.



GBP/USD 4-Hour chart with pink rectangle areas representing the Supply zones, and also enhanced with yellow horizontal Round numbers.



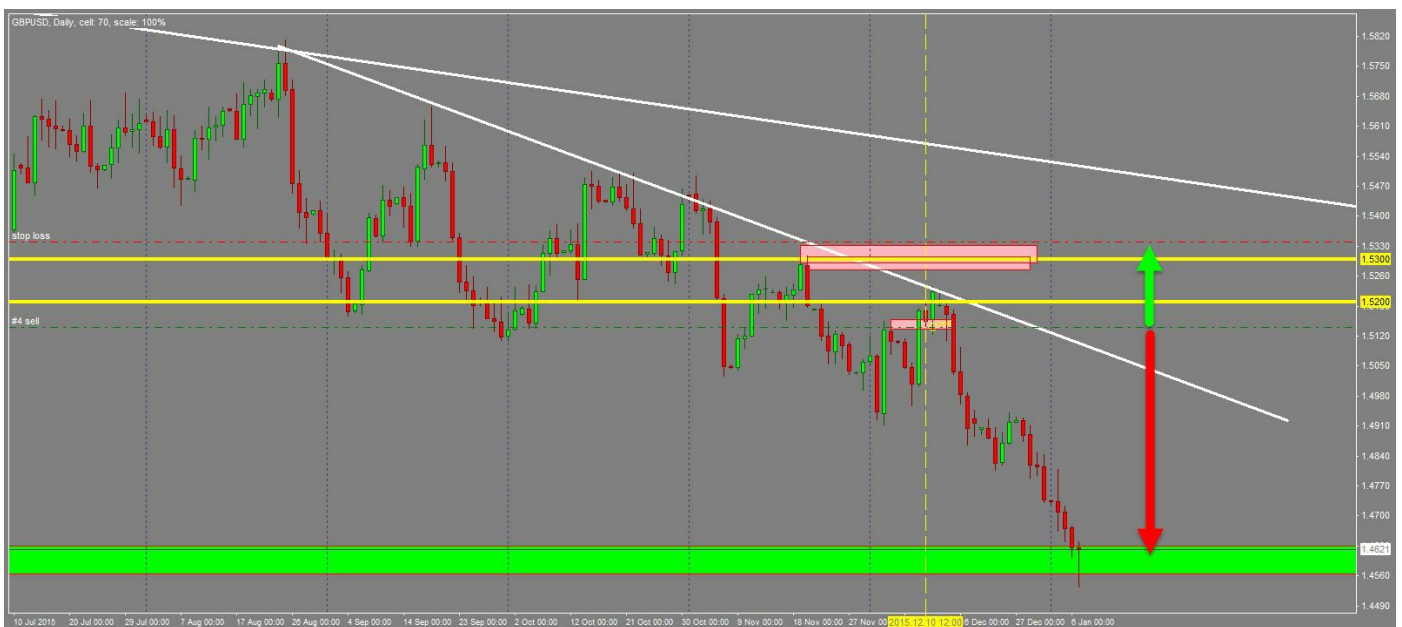
GBP/USD 4-Hour chart. OK, so this is the Event day. I've marked with the second yellow vertical line the actual Time of the release. The Entry to sell was made 12 hours after the Monetary Policy meeting, and the fact of not raising the Interest Rate any time soon, which was expected by the analysts and the trading community. The green arrow points to the 200 point Stop. I've overreacted and placed the Stop above the strongest Supply area. I was not expecting such a vicious upward price movement on December the 9-th, the day before the Event; the currency moved upwards 190 points. I was thrown-off the plan to sell at the nearest 1.5150 Supply area, which by the way was violated, along with the nearest Trend line that has been removed.



GBP/USD 4-Hour chart, 32 hours after the Event. The Pound makes a run for 1.5200 round number; eventually stopping-out group of traders that shorted the currency placing their protective stops just above the '00' Level.



GBP/USD 4-Hour chart, 4 Days after the Event. Clearly price reverts back to its Intrinsic Value almost erasing all the bullish action of December the 9-th.



GBP/USD – Daily chart, 4 weeks later. The Pound traveled more than 600 points to the down side. Even if you did close the whole trade at the green Demand zone, it still would've netted you 2:1 positive ratio. I closed a part of my position at the green Demand zone. That zone was projected from April's lows of 2015-th. I kept the small part of open trade to squeeze more profits, because the data from US was very strong; Interest Rate on the Dollar was finally raised on December the 16-th, then on January the 6-th; ADP Non-Farm Employment and Trade Balance were strong. I kind of assumed that the actual Non-Farm numbers from the Bureau of Labor Statistics on Friday the 8-th would've been also strong, and it was.



GBP/USD 4-Hour chart. As we can see the Pound traveled 1100 points in a six week period. I've exited the rest of my trade on Friday, January the 8-th, three days before the major BOE Gov. Carney speech. Non Farm numbers were great I've managed to squeeze another 150 points that day, and "called it quits" on the entire trade. The Pound managed to drop another 500 points after that, but I was happy - anyway. No regrets, no sorrows; I've participated in the move from the beginning; I was able to get around 50% of the entire move, and that was enough. Yes, I could've and should've trailed the stops to catch the rest, however I was certain that the price action would've given me another opportunity to short on the Trend line bounce, but it never happened. Gov. Carney gave the speech; the Pound took-off to the downside without the correction.

Note: The trade was reproduced from the actual event using Fx-simulator software for illustrative purposes.

6) Manage open trades

This, in my opinion, is the most critical part of your Trading processes.

Managing an open position is not an easy task because your emotions are taking over your logic. How far the Market will move? How soon the correction will take place? Is my stop far enough? Yeah, I'm in profit, do I close now or squeeze a little bit more? Even if you have an Exit plan outlined before the Entry, still so many things can and most certainly will go wrong. How effectively you're managing open positions will determine your overall success. This what helps me to manage my trades – set of rules:

- Always protect yourself, always use stop loss orders. (No Hedging.)
- Never move the stop loss when the Market goes against you.
- Allow the Trade to develop, "sit on your hands" and do nothing*.
- When stopped out, take another shot at a better supply/demand zone, if present.(Two tries maximum, including the original Entry.)
- When in profit 1:1, book 50 -70% of your position**, the rest move to break

even to have a “runner.”

- When in profit 2:1, 3:1 consider Exiting an entire position.
- Close an open trade before the Central Bank’s meeting and minutes, unless you’re certain that a position will not be negatively affected.

** Sometimes it takes several days for the trade to unravel other times it may require even a week.*

*** I use big stop orders; it can range from 75 to 200 pips at times. Therefore when price moves in my favor by the same amount that my stop loss, I’m facing 3 choices – plain break even; book 50% then break even; book 70% then break even. Partial profits booking has worked for me the best, however it is up to you how aggressive the choices should be.*

Here is the brief summary of my Routine:

1. Check Your Carts
2. Do the Research
3. Check the Macro
4. Check the Micro
5. Get the Entry
6. Manage the Trade

In this section, I thought it would’ve been appropriate to cover the Money Management aspect of my Trading as well.

No matter how good of a Trader you are or how solid is your trading methodology, everything will come to crash if proper money management is not applied.

There are many techniques to choose from, I cover the way I do it.

It is very simple yet powerful enough to keep me out of trouble.

I do not risk more than 3% of my account on any given Trade.

For multiple positions, I do not risk more than 10% (combined) of my capital in a 22-day trading cycle.

Consider yourself being an accountant, keep the journal of open trades, keep the track of profit and loss summaries.

Trading is a Business to me, and I treat it as such.

Conclusion:

If your plan is to become a successful Trader, you need to create a Trading Routine with a strict set of rules which you're going to follow day-in and day-out. The routine will allow you to keep your emotions in check and deliver steadier results. In this case, your Trading starts to look like as a steady business activity rather than an irregular part-time Job; no offense was intended for part-timers.

Tips & Guidelines.

- Check ahead Economic calendar for any upcoming news releases, anything colored in red should be paid attention to, especially Central Banks' speeches, meetings and Interest Rates announcements.
- Monitor Market reaction to recent economic and news releases. If a relatively positive or negative news release was unable to move the Market, then there must be a reason why. Find out the "why," was that event already priced-in, maybe we have another major event scheduled and Market waits on the outcome, to move-in aggressively.
- Be aware of monthly and quarterly Options Expirations, keep these dates on your watch list. I wouldn't recommend establishing any new positions on these dates.
- Evaluate the quality of your setup continuously by monitoring the current Macro conditions and views on the currency. Determine if your trading bias lines up with the longer-term perspective. Take into account that as time goes by and longer you maintain your opened trade, the more risk exposure you have on your hands. Prepare to manage an open trade as economic news releases will affect your positions on a day-to-day basis.
- Don't chase the Market. Timing is everything. Prepare yourself for the next trade. Know that perfect trade; where everything just lines up for success, is around the corner.
- Be patient. I can't emphasize this enough, please be patient with your performance. Don't expect to make your money at once, although with this type of trading you will get much bigger pipage. Build your bankroll over a large time period. If you use proper money management, you'll be able to endure almost any Market blow.
- Always know yourself emotionally, trade number of lots you are comfortable with. Measure your emotional reaction as you increase lot sizes over time.
- This is a very valuable trading tip: do not trade when you are sick, have family issues or just simply tired. Psychology or should I say, psychological state of your mind is very important to your trading success. Many retail participants underestimate this aspect, partially because trading nowadays became so

easy and so accessible. You literally can trade in your pajamas, from the comfort of your home, sipping that “kool-aid.” Anyway, **your mind needs to be the sharpest tool in your arsenal**. So please, do yourself a favor, trade when you are in the “zone” - right frame of mind, period.

Conclusion:

Trading the Macro Fundamental events gives you more structured way to approach the Markets. As you may notice this style of trading is more long-term, thus may not be suitable for everybody. On the other hand, if you have a day job, you might be able to combine both, especially if you're not keen on perfect timing as you will be able to make entries from longer timeframes. You can expect to find several good trades on a monthly basis or build quite a large position on one pair which you may carry for several weeks. For instance, if it is true for a Central Bank to set the tone for currency at each meeting, one can expect to trade from one meeting to another, which is every 4-6 weeks, depending on a Bank. The duration and the style will depend on your preference and your personality. After all, you don't need to trade "gazillion" currencies to make money in Fx Markets. It takes one properly structured trade to make your month. Fewer trades, fewer mistakes, less greed.

There you have it; I think I've done pretty good job of covering important topics in regards to Fundamental Macro Trading in a crisp and concise manner. I hope this e-book brought an additional value to your trading and helped you better understand Fundamental intricacies of Trading in general.

I welcome criticism as well as suggestions to improve my book. You can contact me at davematiasfx@gmail.com I'm always here to answer your questions as well.

To your success,
Dave Matias