E-A-R©'s
Flash Note I Forex (FX) and Commodities

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Scene Setting

The hard knocks of trading can send many searching for their "sugar man". The forex/FX market is arguably the marquee financial market in the world. Notably, the FX market presents an intoxicating level of freedom as it trades 24 hours, 5 days a week. There's always some gas in the forex tank! Furthermore, the FX market is decentralised; i.e. there's no central governing authority that controls trading. Thus, there is no "best bid or offer" price. There is no such thing as a single price for a given currency at any given time. In this note, EAR presents a brief amalgam of FX and commodity analysis linking it to one of the main drivers of a particular currency cross.

Main Drivers

More often than not, retail FX traders make extensive use of price charts to formulate their trading strategies. Is that all, though? Certainly not! FX is a news-driven market. There are four broad drivers of currency markets, namely: interest rates, trade balance, growth and political stability/noise. In the FX market you either learn the carry or you pay the price! This notion is more relevant to "longer term" traders. Traders who are on the positive side of the carry stand to receive interest into their account and traders who are short the carry will have interest deducted from their accounts every day. **Noteworthy, the carry trade interest is often paid at the discretion of the broker.** Be that as it may, traders need to choose brokers carefully and most importantly acclimatise themselves to interest rate dynamics that underlie the various currency pairs.

Exchange rates tend to trend or range and this is corroborated by EAR's techniques. Knowing when to apply each is what makes trading all the more challenging. EAR applies the ***modified "z" signal*** which rests on one volatility parameter to indicate the direction. EAR's inclination is such that knowing which technique to apply and when to apply it makes trading all the more rewarding. Related to this is the basis on which certain trading techniques are predicated. EAR considered the CADJPY (Canadian Dollar/Japanese Yen) cross and the Western Canadian Crude Oil Price (USCRWCAS). The aim is to present some dual trading strategy (FX and commodity). The CADJPY cross is one of the simplest ways to express an opinion in the oil and the currency market, more so among some of the liquid crosses. Canada is a beneficiary of a rise in the oil price whilst Japan is a victim. As indicated earlier on; one of the broad drivers of specific FX cross volatility is trade balance. Without having to observe dynamic correlations with regards the CADJPY cross and the USCRWCAS price; EAR leans toward the *modified z signal* under a one-time volatility band regime.

Table 1: Modified Z Signal

Measure	CADJPY	USCRWCAS
Modified *Z signal*	1.2	1.0

Source: Bloomberg (for prices) and EAR

A modified Z signal of greater than 1 provides a signal for a long position (in this case, the implication would be that the Japanese Yen would weaken against the Canadian Dollar) on the back that the USCRWAS price could rise. Interestingly, the modified z signal of the USCRWCAS is still around 1. Therefore, the upward trend in the oil price, albeit insignificant, could just be gaining some traction. Furthermore, the modified z signal of the CADJPY is fairly low and could benefit those who may wish to jump on the trend whilst in its budding phase. Indeed, commodities could provide a signal for another asset class, which is/may be FX. As the search for sugar-man intensifies, in commodities and FX is his trace!

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