

BEAT THE FOREX DEALER

**An insider's look into trading today's
foreign exchange market**

Agustin Silvani



A John Wiley & Sons, Ltd., Publication

Beat the Forex Dealer

For other titles in the Wiley Trading Series
please see www.wiley.com/finance

BEAT THE FOREX DEALER

**An insider's look into trading today's
foreign exchange market**

Agustin Silvani



A John Wiley & Sons, Ltd., Publication

Copyright © 2008

John Wiley & Sons Ltd, The Atrium, Southern Gate, Chichester,
West Sussex PO19 8SQ, England

Telephone (+44) 1243 779777

Email (for orders and customer service enquiries): cs-books@wiley.co.uk

Visit our Home Page on www.wiley.com

All Rights Reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning or otherwise, except under the terms of the Copyright, Designs and Patents Act 1988 or under the terms of a licence issued by the Copyright Licensing Agency Ltd, Saffron House, 6–10 Kirby Street, London, EC1N 8TS, without the permission in writing of the Publisher. Requests to the Publisher should be addressed to the Permissions Department, John Wiley & Sons Ltd, The Atrium, Southern Gate, Chichester, West Sussex PO19 8SQ, England, or emailed to permreq@wiley.co.uk, or faxed to (+44) 1243 770620.

Designations used by companies to distinguish their products are often claimed as trademarks. All brand names and product names used in this book are trade names, service marks, trademarks or registered trademarks of their respective owners. The Publisher is not associated with any product or vendor mentioned in this book.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold on the understanding that the Publisher is not engaged in rendering professional services. If professional advice or other expert assistance is required, the services of a competent professional should be sought.

Other Wiley Editorial Offices

John Wiley & Sons Inc., 111 River Street, Hoboken, NJ 07030, USA

Jossey-Bass, 989 Market Street, San Francisco, CA 94103-1741, USA

Wiley-VCH Verlag GmbH, Boschstr. 12, D-69469 Weinheim, Germany

John Wiley & Sons Australia Ltd, 42 McDougall Street, Milton, Queensland 4064, Australia

John Wiley & Sons (Asia) Pte Ltd, 2 Clementi Loop #02-01, Jin Xing Distripark, Singapore 129809

John Wiley & Sons Canada Ltd, 6045 Freemont Blvd, Mississauga, Ontario, L5R 4J3, Canada

Wiley also publishes its books in a variety of electronic formats. Some content that appears in print may not be available in electronic books.

British Library Cataloguing in Publication Data

A catalogue record for this book is available from the British Library

ISBN 978-0-470-72208-4 (HB)

Typeset in 10/12 Times by Laserwords Private Limited, Chennai, India

Printed and bound in Great Britain by TJ International, Padstow, Cornwall, UK

Contents

Acknowledgments	ix
Introduction	xi
PART I THROUGH THE EYES OF A TRADER	1
1 On Markets	3
2 The Currency Market	9
3 A Rare Breed	13
4 FX Dealers	19
5 Today's FX Market	23
6 The Players	27
PART II THE RETAIL SIDE OF THINGS	33
7 Card Stacking	35
8 Don't Trust Your FCM	43
9 Third-Party Services	47
10 Fighting Back	51
PART III JOINING THE 10 %	55
11 Becoming a Great Trader	57
12 Picking the Right Approach	63

PART IV	FX TRADING TIPS	73
13	Adapting to the FX Market	75
14	Trading Thin Markets	83
15	Using the Crosses	87
16	All About Stops	93
17	Characteristics of FX Trends	97
18	Trading the FED	103
19	Fading News	109
20	FX Analysts: Who Cares?	113
PART V	DEALER TRADES	117
21	Trading Against Dealers	119
22	The Big Figure Trade	123
23	The Friday to Sunday Extension	131
24	Sticking it to Your Dealer	137
PART VI	THE FUTURE	143
25	The End of the Beginning	145
APPENDIX	TRADING “HOW TO’S”	149
	How to Set Up Your Trading	151
	How to Trade Price Action	157
	How to Build a Position	163
	How to Trade Out of a Losing Position	169

NOTES	177
Speaking Like a Dealer	179
FX Glossary	181
Trading Maxims	189
Bibliography	191
CFTC Minimum Finance Requirement	193
 Index	 209

Acknowledgements

This book required the expert help and contributions of a wide range of friends and colleagues. Special thanks go out to all of the great people at MIGFX, whose hard work and dedication to trading gave rise to this project. I would also like to give special thanks to Richard Hoffman for his help and dedicated research, and to the many industry contacts whose insights proved invaluable. Without you this book would not have been possible.

I would also like to thank the great people at ProRealTime.com for granting me permission to use their fabulous charts. Every trader should visit their website and check out their charting packages, for they are truly top-notch in the industry.

Introduction

Over the years, I have tried to get my hands on every currency trading book that I could find, but as you may well know the pickings are slim when it comes to FX literature. Apart from a few notable exceptions, most of the available material seems to fall into one of two categories: unabashedly theoretical or completely misguided. The dry, outdated, and sometimes esoteric academic works tend to leave the reader with the perception that currency trading is as gentlemanly and ordered as the world of stamp collecting, when in reality nothing could be further from the truth in a market referred to as a “slaughterhouse” where traders routinely get “chopped up”. The FX market I know is one of egos and money, where millions of dollars are won and lost every day, and phones are routinely thrown across hectic trading desks. This palpable excitement has led to the emergence of a second class of literature, often misleading and downright fraudulent, where authors promise the reader riches by offering to make forex trading “easy”.

Well, I’ll let you in on a little secret: there is nothing easy about trading currencies. If you don’t believe me, then stop by Warren Buffet’s office and ask him how he could lose \$850 million betting on the dollar or ask “King” George Soros why his short bets lost him \$600 million not once but *twice* in 1994. Don’t these guys read FX trading books? If these investment legends can lose billions in the FX market, what makes anyone think there is anything easy about it?

The average retail trader must feel a terrible disconnect between what is described by famous “experts” and their actual trading experiences. Theory very rarely translates into fact when it comes to trading, and real-life FX trading is much more complicated and tricky than any guru would have you believe. In this jungle it is a kill-or-be-killed attitude that marks survival, and the minute you step on to the playing field a target has been placed next to your account number.

Realizing that most FX books in print are either written by scam artists or academics with little real-world trading experience, I decided to put my own thoughts to paper. While I certainly do not proclaim to be any sort of market wizard, the market insights I have gained while managing a successful currency fund should prove valuable to readers, even if they are just starting their trading careers. Being a firm believer in the “small is beautiful” mantra, I have therefore tried to keep this book short, and to the point.

The purpose of this book is two-fold. First, by explaining the day-to-day mechanics of the FX market and pointing out some of the more unsavory dealings going on in the retail side, I hope to make evident for the reader the risks and rewards involved in currency trading. The second objective of the book is to help turn average traders into winning traders. “Average” traders are losing traders; winning traders are in fact quite rare. However, by highlighting some market-proven trading tricks and techniques, I hope to give traders an initial leg-up.

As you may have guessed, this book takes its name from Edward O. Thorp’s landmark work on blackjack, *Beat the Dealer*. In 1962, the MIT mathematics professor revealed to the public the gambling industry’s tricks and traps, while at the same time managing to teach a successful method for playing the game of twenty-one. Likewise, you will find this book roughly split into two parts: the first half is dedicated to revealing the foreign exchange market’s unfair practices and the second half is designed to help the retail FX trader implement an effective and winning game plan by providing trading tips and detailed examples.

FROM VEGAS TO WALL STREET

The past five years has seen the FX market open its arms to nontraditional participants, and now everyone from dotcom investors to cash-strapped grandmas are jumping in hoping to strike it rich.

What most of these new participants fail to realize is that they are stepping on to a battlefield littered with the remains of day traders and genius “systems”. It is frequently noted that over 90 % of FX traders do not survive in the long run, yet you won’t find that statistic in any of the publicity dished out by the FX brokers. To be profitable, retail traders must realize that the foreign exchange market was fundamentally developed as a professional’s market, and its outdated conventions and procedures mean that it still is very much geared toward the professional. In a market where the retail trader exerts little (though growing) influence, most can have little hope of success.

The retail brokers who have sprung up recently would like you to believe that currency trading is a high form of financial speculation. In reality, the average client’s trading approach combined with the unscrupulous practices of some brokers make spot FX trading more akin to the games found on the Vegas strip than to anything seen on Wall Street. The new breed of on-line FX brokers simply share too many of the traits employed by casinos to stack the odds in their favor, including these:

- The “house” always has the advantage (the spread).
- The “house” feeds off the player’s greed and actively promotes it (by offering trading signals, excessive leverage, and fancy platforms resembling slot machines!).

- The “house” adopts various dubious risk-management controls, which include cheating and cutting off winning players.

All of these benefits ensure that, in the long run, the house (broker) will end up with virtually all of the player’s (trader’s) money. The odds are simply stacked in their favor.

Thorp’s original *Beat the Dealer* was brilliant in that he focused his energy on a niche game (blackjack) which featured changing odds. In a game with fixed odds (such as the lottery) a player is virtually assured ruin, while a game with shifting odds allows the smart player to effectively control his risk while maximizing his gains. Although the long-run odds may not favor the player, a set of rules can be adopted that allow the gambler to “play” only when the odds are in his favor, thus greatly improving his chance for success. Playing in this way enables you to refrain from gambling (betting on luck) and concentrate on playing the probabilities. FX traders need to take a cue from their card-playing counterparts and learn to trade only when the odds are shifted in their favor. In this spirit, the last part of this book is dedicated to exposing high-probability trades commonly seen in the intra-day FX market, which can effectively be used to “double up” when they are seen.

BEAT THE DEALER

In my experience, most retail FX traders seem to have a decent system or genuine “feel” for the market, yet more often than not they still find themselves posting steady losses. They see the possibility for greatness, yet they are unable to grasp it. Something must be missing...but what? Although they may spend hours dutifully studying technical analysis, candle charting, and the history of the market, seldom do they take a moment to concentrate on their number one killer: the forex dealer. By preying on the small speculator, these shadowy characters are often single-handedly responsible for turning winning trades into losers.

Both casinos and FX brokers have an ace up their sleeve which ensures that the odds are always shifted aggressively against a player, and not surprisingly these villains share a common name. Dealers are much more than simple order-processors (do you want to buy/sell, hit/stay?); they are in fact the house’s fail-safe device sent out to take down any player who is deemed to be winning “too much”. Their direct and purposeful interference can ruin even the most advanced or elegant trading system.

Have you ever had your stop hit at a price that turned out to be the low/high for the day? Bad luck perhaps? Maybe. What if it happens more than once? Do you ever feel like the market is “out to get you?” Well, guess what...in this zero-sum game it absolutely is.

Dealers make particularly tough opponents for traders because they act on better information. Although it is hard to bluff when the other party knows your cards, you *can* however profit by betting on their actions, and a dealer’s actions are, after