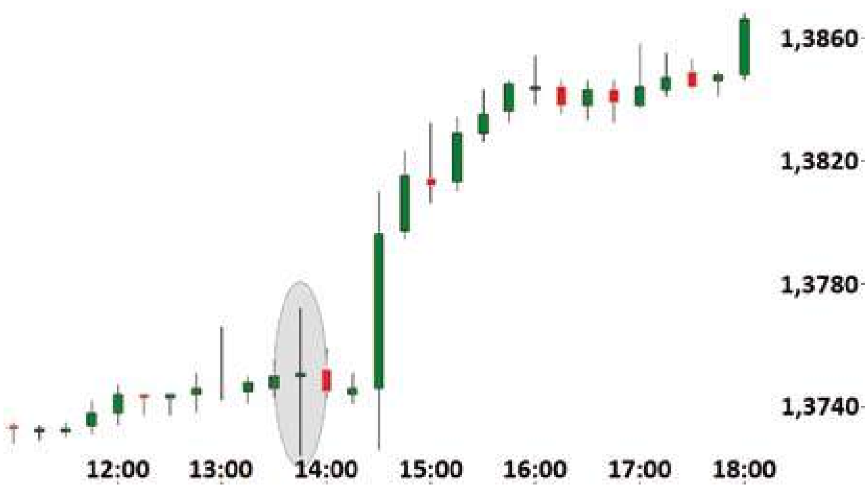
News Trading in Euro/Dollar

How to Take Advantage of Big Events at the Stock Markets

Traders always search for volatility – there is even a dependency of it, because without market movements you will not earn profits. Around the time of the publication of important economic news the stock markets often show erratic movements in many underlyings. We show you how to use these movements successfully with an example of EUR/USD.

F1) EUR/USD on the Day of the ECB-Decision



On this day, the 6th March 2014, the ECB published an interest-rate decision at 1.45 pm (see mark).

Source: www.trading-stars.de

» The Trading Idea

There are days when prices only move in slow-motion – there are only sideways phases and many false breakouts. But then there are days where everything changes: dynamic breakouts up or down, sometimes even to both sides within minutes. These events can take place completely unplanned (for example because of attacks, riots, natural disasters) or predictably at big news-events like the publication of the gross domestic product (GDP) or the NFP-data (non-farm payrolls) or a press conference of the Fed. Dynamic price movements take

» If price has decided for one direction, will it stay there for the next hour? The answer is in general "yes". «

place, but you know the date and time in advance. We want to introduce a trading idea based on the monthly ECB-interest rate decision and we want to show that we can recognise a mathematical probability advantage and use it for a real profit.

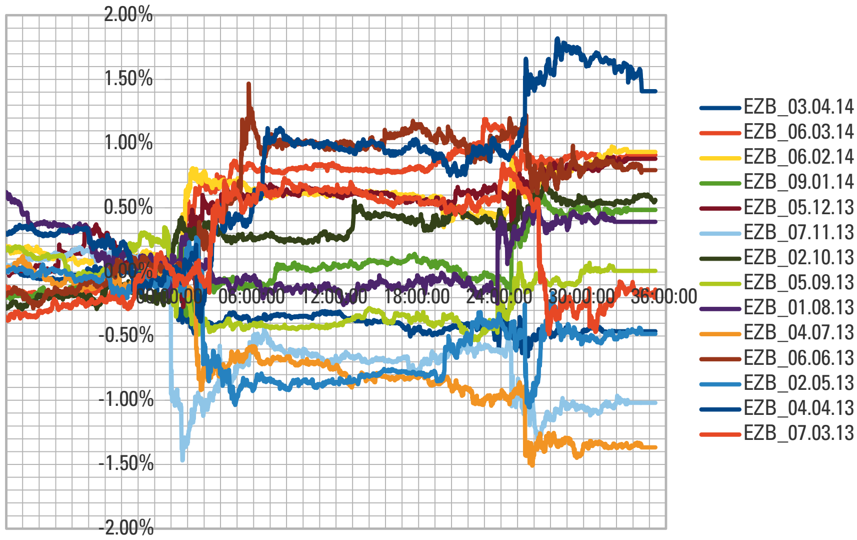
An old saying goes: "Close your trades prior to important news or at least protect them with a stop-loss."

This is absolutely true. There may be some insiders who know in advance what will be published, but the reaction of the market is hard to predict. For example nonfarm payroll data is published and they are better than expected, which should mean a bullish move. But maybe because of this the market fears that the monetary measures will be reduced and therefore the DAX drops 100 points. In hindsight we can always explain the "Why". But to be honest, this could be an explanation for the contrary as well. The consequence is clear: Stay still and close open positions – unless you want to trade the news systematically.

Assumption and Reasoning

Is it reasonable to trade the break-out of a certain price-span prior to the news? Or put differently: If the price has decided for one direction, will it stay there for the next hour? The answer is in general "yes", but this has to be proved. We evaluated the last 14 ECB-decisions (a period of more than one year) and measured the change in price of the EUR/USD

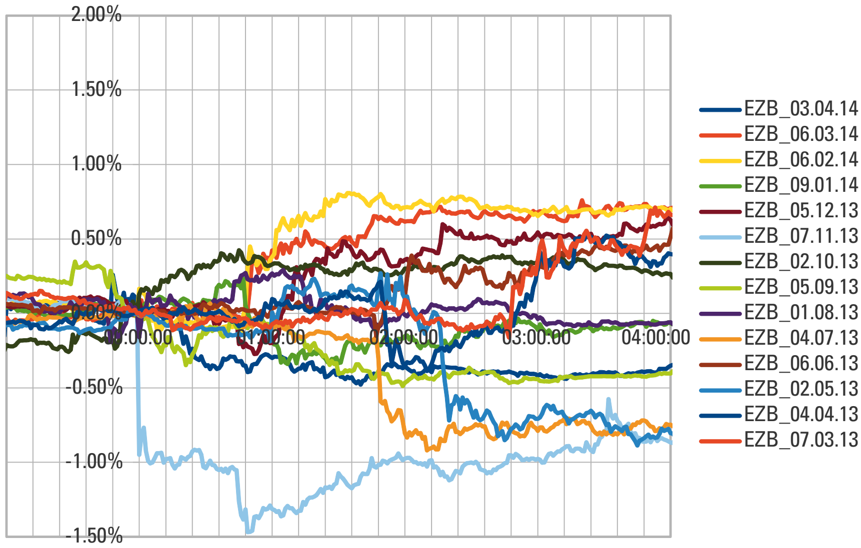
F2) Relative Change of Price EUR/USD



You can clearly see the higher volatility at the time of the ECB-decision. The x-axis shows the time difference in hours based on 1.45 pm. Therefore we look at the price development twelve hours before and 36 hours after the decision.

Source: www.trading-stars.de

F3) Relative Change in Price EUR/USD in Detail



In this picture we zoom in the time around the decision.

Source: www.trading-stars.de

F4) Order Placement

This picture shows how to place the orders in EUR/USD. The candle at 2.15 pm activated the long-order. At the same time the short-order was deleted. The stop-loss was placed at the close of 1:44:59 pm.

Source: www.trading-stars.de

in relation to the price at 1:44:59 pm – the price prior to the news. You can see the result in Figure 2.

Watch the Regularities

Prior to the news it is often very quiet. But with the publication of the decision the movement comes back to the market and you can often see that the first direction stays in the aftermath. After about six hours everything is over and the price stabilises. Only once (on 7th November 2013) the price movement started in the first few seconds. Some times the movement only started 45 minutes after the decision (press conference). Clear "fake signals", which means that the price "feints" one direction and then turns, do not happen that often.

Entry

It is not difficult to create a profitable trading strategy based on this data. A detailed evaluation showed that it is wise to place a stop-limit and a stop-sell order 0.3 per cent below respectively above the close of 1:44:59 pm. That means we enter long if the price increases by 0.3 per cent after the interest rate decision or short if the price decreased by 0.3 per cent.

Back-Calculation

You can see in Figure 5 that it is ok to close the trade after about six hours. Afterwards there is not that much movement. We placed a stop-loss at 0.3 per cent below/above the entry and therefore a profit of three per cent (see chart after six hours) means that we earned ten times more than we risked. A nice result – with only 14 ECB-interest-rate decisions.

F5) Aggregated Movement of EUR/USD

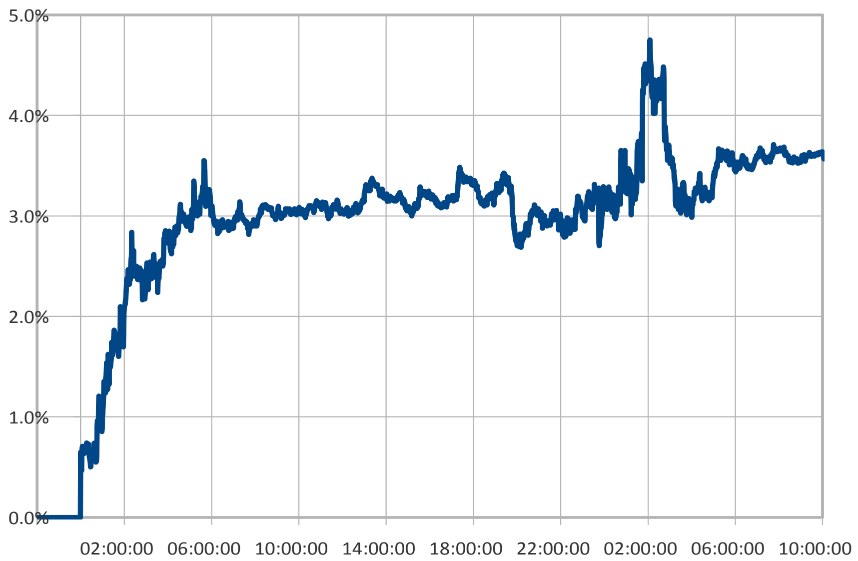


Figure 5 shows the average movement of the EUR/USD in per cent (increasing or decreasing) for the last 14 ECB-interest-rate decisions assuming that the same rules were used.

Source: www.trading-stars.de

Risk Management with 1R-Rule

If you trade the strategy consequently and you always risk 1R you get the equity curve shown in Figure 6 after 14 months. Please notice that we did not determine "R" as a percentage of the trading capital, but with an absolute amount (for example 100 EUR per trade). Only then you can create professional linear lines in the equity curve.

Position Size Management

We place two orders at the last 15-minute candle prior to the decision: One stop-buy order 0.3 per cent above the price and one stop-sell order 0.3 per cent below the price. If one of the two orders is executed, the other one is cancelled (one-cancels-other (OCO)-order). The close equals the stop-loss of the position. Because of the relatively close stop and the unlimited take profit we get a very attractive risk-reward ratio at the end of the trading day.

Exit

After a trade is opened there are two possibilities to exit. Either the position reaches the close (and the stop-loss) before the news or we close it in profit. We use a fixed exit time at 10 pm. On the one hand it is statistically proven that afterwards there is no dynamic movement and on the other hand we exclude the risk of price movements overnight at low liquidity. Furthermore you have to pay overnight fees with some brokers. Another advantage is that we do not hold a position over the weekend and therefore weekend-gaps are not an issue.

The Quality of the Broker Is Important

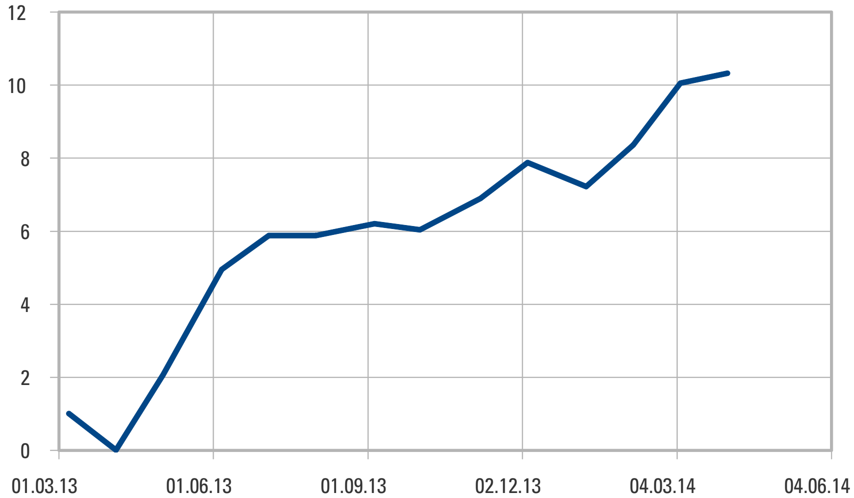
The choice of the right broker is very important with this strategy. The size of the spreads (difference between ask and bid) and slippage (difference between placed order and executed order) can have a negative effect and therefore you should always consider these facts when choosing a broker.

R-Multiple

The concept of the R-multiple was introduced by a trader named Chuck Branscomb in 1993 and published by Dr. Van Tharp. It is a method to make trading strategies comparable in different markets and it does not only compare the absolute profits. The R-multiple is the profit or loss of a trade in relation to the initial risk. The initial risk is the difference between entry price and stop-loss.

An example: A trader buys the stock X at 100 EUR and places the stop at 95 EUR. The initial risk is five EUR. This value is 1 R. If the trader sells the stock at 110 EUR the profit of ten EUR is in relation to the entry risk a R-multiple of 2 (10 / 5). If the trade is stopped out at 95 EUR the R-multiple is -1 (-5 / 5). You always divide the trade-result by the initial risk.

F6) Equity Curve in R-Multiple



You see an equity curve with a nice linear development and with only small drawdowns.

Source: www.trading-stars.de

decisions of the ECB the Fed-sessions can also be used for trading – because the central banks direct the monetary policy and the interest rate (the price of money) decides about the engine of the markets, the liquidity.

There are numerous events that lead to higher volatility and possible trading strategies. The employment data show the current development of the economy and serve as basis for the decisions of the central banks. In Germany the Bundesagentur für Arbeit publishes the monthly figures as well as the current unemployment rate. In the US there are different figures: for the stock markets the monthly employment data – the so-called nonfarm payrolls – are the most important. It is published on the first Friday of each month at 2.30 pm German time.

Early indicators shall give an indication about the development of the economy and often serve as basis for the decisions of the central banks. The ifo-Geschaeftsklimaindex is important in Germany and therefore it moves the stock markets. In the US the same goes for the ISM. It is published on the first working day of the month for the past month.

Strategy Snapshot

Strategy Name:	Trading Stars ECB-interest-rate decision
Strategy Type:	News trading
Time Frame:	Intraday, 15-minute chart
Entry:	0.3 per cent above (long) or below (short) close prior to the news, OCCO-order
Stop-Loss:	Close prior to the news
Exit:	Stop-loss or time-stop at 10 pm
Risk Management:	1R (absolute) of the trading capital

Economic Data with High Relevance

Many market participants adjust their behaviour to fundamental news and economic data – the market shows higher volatility and dynamic movements at these events. In addition to the mentioned interest-rate

Conclusion

If you have the right strategy, news trading can be very profitable. It is always wise to search for advantages in probability and to use them for profit. You can also create strategies for other news events and for nearly all liquid underlyings like the DAX or gold. «

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