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Trading foreign exchange on margin carries a high level of risk, and may not be suitable for all investors. The high degree of leverage can work against you as well as for you. Before deciding to invest in foreign exchange you should carefully consider your investment objectives, level of experience, and risk appetite. The possibility exists that you could sustain a loss of some or all of your initial investment and therefore you should not invest money that you cannot afford to lose. You should be aware of all the risks associated with foreign exchange trading, and seek advice from an independent financial advisor if you have any doubts.

## ***THE FOREX REPORT***

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J U N E 2 0 0 6

# Trade the News

By Scott Owens

**Most traders intuitively know that major news events drive FX price action, but few trade the news proactively. In fact, most traders avoid news events simply because they lack the tools and information needed to trade the news effectively. Now, the introduction of a toolkit specifically designed to trade the news makes a new, compelling method of trading available to FX traders for the first time.**

### ANALYSIS

- Understanding the drivers of price action
- Context: the most critical element of any trading system
- Targeting news event driven price action
- Automation as the key element of any news trading approach
- Why trading the news is actually a conservative strategy
- See recent sample trades with charts

### ACTION

- Trade the news with FX Engines!
- Get familiar with the FX Engines Trade the News Toolkit

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### RELATED MATERIAL

Test-drive FX Engines for free online at [www.fxengines.com](http://www.fxengines.com) to see the power of trading the news first hand.

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### ABOUT THIS REPORT

The Forex Report is a periodic publication that investigates strategies for superior trading performance in the foreign exchange markets. These reports utilize advanced statistical and econometric modeling techniques to create new insight into the trading strategy of the average trader. This report, Trade the News, is a general report intended for all audiences, including those new to the forex market.

To learn more about The Forex Report or to register for delivery of all future reports by email please visit [www.fxengines.com](http://www.fxengines.com).

# ANALYSIS

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All traders want an edge. In pursuit of that extra advantage, traders will pay thousands in training, subscribe to black-box signal services, and build trading systems using signals they barely understand. The desired end result is a system that can be used repeatedly for profits beyond those offered by traditional investment alternatives. Most traders fail.

To find out why, we dissected price data from the past five years and emerged with a single conviction: *forex price action is driven by news events.*

We learned that the systems most people use are fundamentally flawed, and we learned that most traders avoid the very thing that could lead to their success because of a lack of tools. This report exposes the reality of trading the news: the empirical, analytical support for the concept and the introduction of a new set of tools from FX Engines specifically designed to extract profits from these amazing price moves.

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## DRIVERS OF PRICE ACTION

From a distance, market action in the forex markets represents pure chaos. One minute the market can be completely flat while another can witness 10-pip tics in both directions. Prices can trade in a range for months, then suddenly jump out into a major trend lasting equally long. What drives it?

To understand the drivers of price action one must understand the participants in the market. The world's daily FX volume is created by a myriad of constituents: governments, banks, corporations, investors, traders, et al. Each of these constituents brings with it certain goals for their participation, and each brings a transaction volume. The sum of these goals and their corresponding volume is the price action seen each day in the markets.

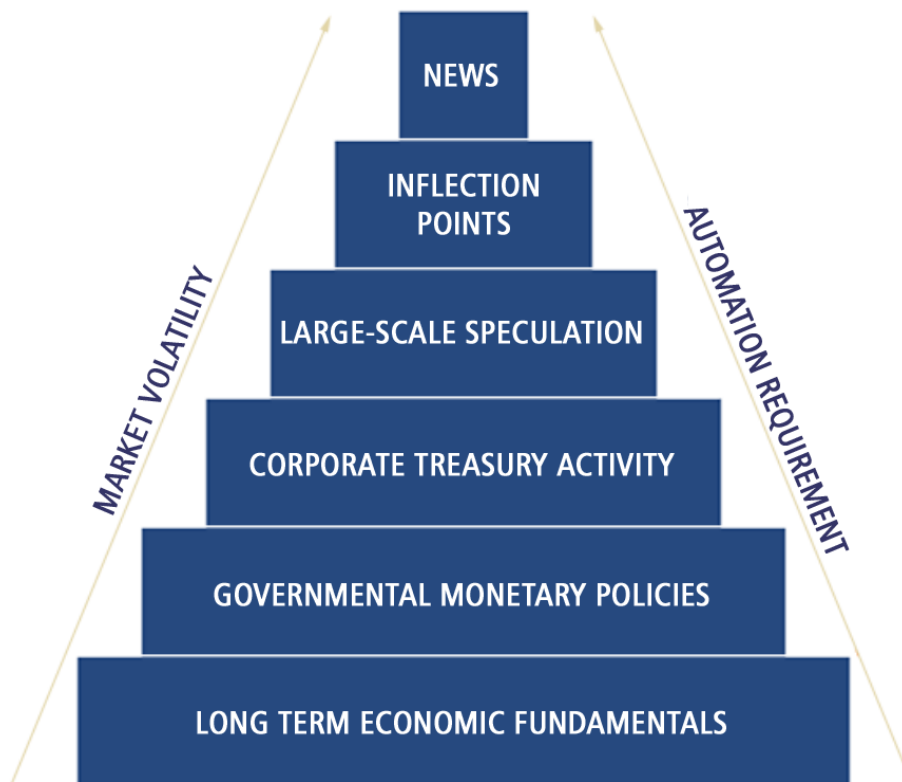
At the most basic level, foreign exchange rates are derived from long term economic fundamentals. These variables measure and weigh the value of one currency vs. another. Think of these economic fundamentals as the tide, ebbing and flowing over time. Indeed, these macro-factors can lead to the very long term trends we see in weekly and monthly charts.

Go a little closer to the surface and you will see a variety of price action driven by governments protecting their currency, corporations and banks transacting true currency swaps, and traders speculating according to differing timelines and investment goals. Each of these constituents can cause price action that goes with the tide or against it, depending on their market power at the time of their transactions.

At the very surface level we have a constant hunt for equilibrium. The market wishes to always have a complete, correct value for the exchange rate for two currencies, but it does not always have complete, correct information. The passing of inflection points and, more importantly, major economic news events, gives the market the information it needs to re-evaluate exchange rates and make instant changes.

**Figure 1: Drivers of Price Action**

The closer the price action is to the 'surface' the more volatile it becomes. Fast, volatile trading demands automation.



When the market receives this information, it quickly discerns the equilibrium gap and moves to correct it. This movement can be

instantaneous and violent, moving 100 pips in minutes, or in a steady march of 40 pips to equilibrium.

Because these events are instantly reacted to by market participants with very large transactional power, these news events actually move the markets. Our Event Reports for the major economic news events demonstrate this emphatically: news is the driver of the forex markets in the short term.

This realization is important not only because it paves the way for a new kind of trading, but also because it shows why most trading systems used now are likely to fail.

### **TRADING WITHOUT CONTEXT**

Somehow traders have been confounded these past 30 years. Rather than building systems from well-understood economic fundamentals, traders have moved into building technical systems they barely understand. These technical indicators are all based on price, but it's all *historical* price.

They certainly look great on a chart. A quick look at an MACD curve crossing can lead a trader to believe he's found a money printing machine, but in actual trading these signals, which occasionally work, fail all too often. Why?

*Technical indicators lack context.* If a trader has a system based on an MACD cross, he cannot be guaranteed that each MACD cross will occur in the midst of a sizable price move. Some crosses will happen into a 20 pip move, some into a 100 pip move, some into an immediate reversal. The forex trader cannot know which, because he simply lacks the information (like volume) to tell him that his system will produce a trade in a fertile market environment.

In contrast, consider a news trade. If a trader knows that tomorrow at 8:30 AM EST there will be tremendous volume and a highly fertile market environment, he suddenly has the context his system has been lacking. Now he can do one of two things: he can trade his system in advance of the news, hoping to get lucky for one of those 100 pip rides, or he can trade the news itself.

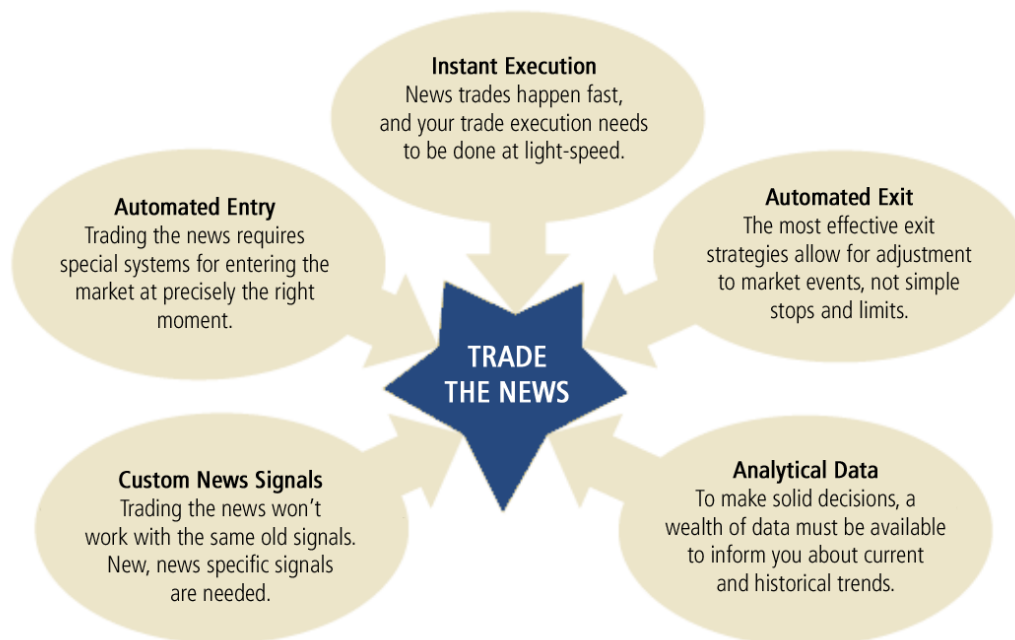
## TRADE THE NEWS

Ironically, the FX market's greatest profit opportunity is also the most intimidating kind of trading. In fact, most individual traders *avoid* the news, exiting positions before major events or moving stops up in a defensive trading posture. Any why wouldn't they? If you watch a news spike happen in real time, it can be an intense roller-coaster ride of a trade.

Faced with that kind of fast, volatile price action, most traders retreat. In some cases traders happen to be in positions that agree with the news spike, and their systems carry them to highly profitable trades. But what was the driver of that profit – the system or the news event that ignited the markets? We contend that news events drive nearly all major FX price action. That your system happens to be in the market when one of these spikes happen is pure luck and should not be the foundation of any trading system. Instead, the price action itself should be traded, using a special set of tools, shown in Figure 2, below.

### Figure 2: The News Trading Toolkit

Ready to trade the news? *Caveat Emptor!* Trading the news is a niche strategy that requires niche tools. Don't be fooled into thinking your average FX dealer, who has little technology expertise, can provide them. FX Engines is a software company built to trade the news.



Trading the news is dependent on the immediate recognition of a price

spike and its direction, followed by the immediate entry of orders. This can only be achieved with signals that can sense the news and act on it. Once in the market, the trade must be managed tic by tic to provide the optimal exit point. The understanding of an 'optimal' exit point can only be found through long term data analysis. Finally, the system should employ multiple entries and multiple exits to result in an overall trade that's blended, where no single price movement in moments after the news announcement can derail a big gain.

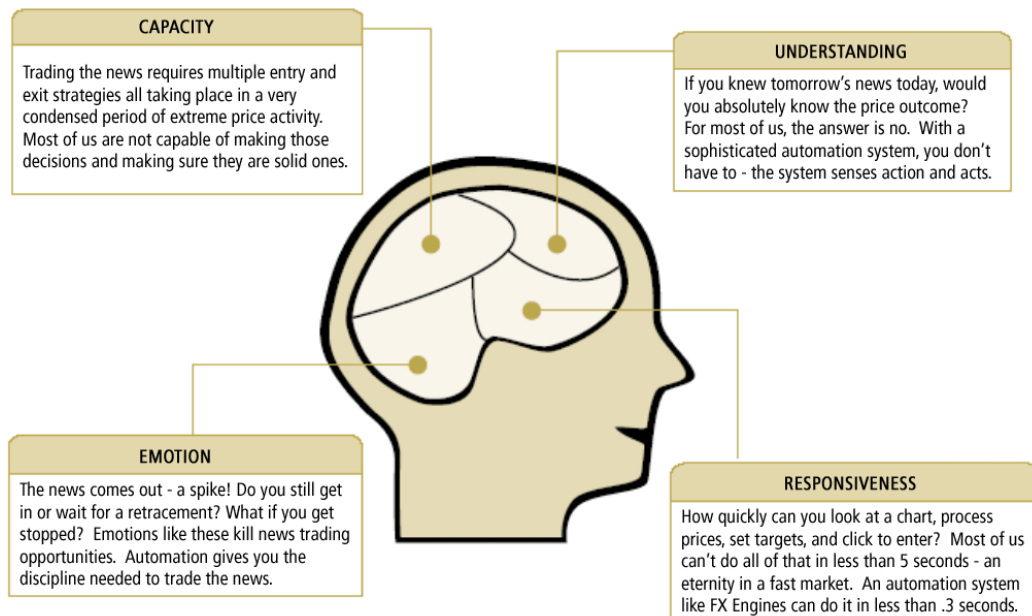
The problem is twofold: most humans simply cannot manage all of those tasks at a high level and nearly all FX dealers provide only simple trading tools with no provision for helping traders manage these kinds of sophisticated strategies. Without a news-specific toolkit to offset both of these issues, news trading is too risky. But with that toolkit, a new method of trading – more conservative in many ways than most trading but with far greater potential – is born.

### THE AUTOMATION FACTOR

Manual trading is difficult, even for long term traders. But in fast, short term markets, the limitations of a manual trader are exacerbated, as shown in Figure 3, below.

#### Figure 3: The Limitations of a Manual Trader

Traders have to contend with an immense information load, process all variables, and put a plan into action, instantly.



On the other hand, automation alone is not the answer. When paired with the same old technical indicators lacking context, automation can even deliver worse results because of over-trading. However, when paired with a contextual trading strategy automation can be extremely effective.

Of all the benefits of automation, the one most important to trading the news in FX is speed of execution. Processing the events following a news release can be very time consuming at a time when 15 seconds can witness a major price change. Automation systems equipped with the right signal technology can instantly sense different levels of price spikes and put the trader into the market in a fraction of a second. This cannot be matched by a manual trader.

Additionally, the deployment of multiple trading positions into the market, each with its own exit system designed to perform specific tasks, is critical. A manual trader will have difficulty getting one trade placed, not to mention 15 trades simultaneously. This broad approach to trading allows the trader to take profit at fixed points or contextual levels, protecting early gains while allowing big moves to run their course.

Speed, flexibility, discipline, and responsiveness are critical elements for trading the news. Automation clearly provides all of these, and if an automated system was equipped with news-specific signals and analytical data, the ideal news trading platform would result.

## **TRADE THE NEWS WITH FX ENGINES**

The FX Engines trading platform presents a solution to all of these issues as well as a complete, ongoing guide to trading the news. Let's walk through a potential trade:

### *Sunday Evening*

FX Engines delivers its weekly news calendar via email. Each calendar shows the upcoming week's major news events and summarizes each one, including a rating for the event based on its past price action. You note that Nonfarm Payrolls, a top-rated event, comes out Friday at 8:30 AM EST.

### *Thursday Evening*

FX Engines posts its Event Alert for the Nonfarm Payrolls release Friday morning. This alert includes detailed data about the Nonfarm Payrolls

announcement, its expected impact, its historical price action in detail, including charts, and suggested trading strategies.

Based on the recent price activity and the historical patterns of the Nonfarm Payrolls report, you determine that tomorrow's trade will be smaller than normal, so you choose exit strategies that protect profit early but give the trade a chance to run.

You log into your FX Engines account and click on ENGINES. You subscribe to our 10 ALL MAJOR US EVENTS engines, which gives you 5 strategies, long and short.

Each of these engines has an automated entry and exit. The entries all use our instant spike signal – getting in the market just after the news event in the direction of the event. The exits vary depending on the type of profit taking you wish to execute. The Ultra-Conservative, for example, takes profit quickly, while the Ultra-Aggressive engine lets the trade run and takes profit much later.

#### *Friday Morning*

At 8:30:00 AM EST the Nonfarm Payrolls report is issued, and there is an immediate price spike long. Your 5 long engines all get in the market immediately. The short engines expire after 3 minutes, automatically.

Because this trade instantly jumps out to +30, two of your positions have already closed with the +15 limit exit. The remaining 3 trades run their course.

#### *Friday Afternoon*

The markets have calmed down, and your trades have exited. The 3 remaining trades were automatically closed with an average 62 pip gain after your trail was hit. Including the 30 pips you made earlier, your net gain for the day is 216 pips. Your total risk to achieve that gain was 60 pips – the sum of your original stops (12 pips per trade). If your account balance at the beginning of the day was \$5,000, the 60 pips represented 1.2% equity risk. The 216 pips would be a 4.32% gain.

FX Engines is a mature, hosted automation platform that can enable the strategy just described and more. We've spent years honing our trading logic, our technology, and our analytics to bring this strategy to the trading public. We believe trading the news using FX Engines holds the most promise of exceptional returns for traders, and we're able to support that promise with real data.

## **SCHEDULE YOUR TRADES**

Whether you wish predict price direction or the magnitude of price movements, the ability to accurately forecast FX price action is rare. Similarly, most people do not possess the ability to accurately predict the direction of the market following a news event, since so many variables are involved.

The good news is that you don't need to be able to do any forecasting to succeed trading the news. Each week's events are posted with their release time, and with FX Engines' vault of analytical data for each release, we can draw a fairly good picture of when and how to trade. By creating scheduled orders using our custom News Spike signals, you assure yourself of being in the market *in the direction of the spike*.

## **THE ADVANTAGE OF TIGHT STOPS**

Since trading the news is based on trading price spikes, it's not practical to use a wide stop. In fact, news trading strategies can use stops as tight as 10 or 12 pips. Since you have the historical data to show you each event's expected magnitude, you have an unheard of ability to create a trade in a fertile market environment with very little risk.

In fact, using FX Engines to trade the news can be one of the most conservative strategies you will find. Many systems call for stops of 30, 50, or 100 pips. With stops of that magnitude, the danger of consecutive losses can put otherwise sound trading systems into double-digit drawdowns. With the tight stops of news trades, that's highly unlikely. A single contract with no leverage and a 10 pip stop is just a .1% equity risk. Even with modest leverage and a handful of consecutive losses, the risk of high drawdowns is low.

## **THE APPLICATION OF LEVERAGE**

Of course, the advantage of tight stops also extends to the trader's ability to employ leverage. A system with a 10 pip stop can trade 10 times the number of contracts than a system with a 100 pip stop can, with no risk increase. Take a look at the examples in Figure 4 to see the power of leverage in a news trading system:

**Figure 4: Leveraged Value**

Even modest price moves can generate incredible returns with leverage. However, the downfall of most traders is using leverage with wide stops. With an FX Engines news trade, leverage can be employed conservatively.

	Position Size: 1%	Position Size: 2.5%	Position Size: 5%
Balance	\$100,000	\$100,000	\$100,000
At-Risk Capital	\$1,000	\$2,500	\$5,000
Stop Loss	15 pips	15 pips	15 pips
Contracts	6 (100K)	16	33
Average Profit	25 pips	25 pips	25 pips
Average Gain	\$1,500	\$4,000	\$8,250
Total Return	1.5%	4.0%	8.25%
High Profit	100 pips	100 pips	100 pips
High Gain	\$6,000	\$16,000	\$33,000
High Return	6%	16%	33%

As you can see, the potential for a news trade to make exceptional returns is high. When combined with the equity risk for each trade, the number of trades per month (over 20 major events), and the arsenal of tools available to you for trading the news with FX Engines, you have a compelling new approach to trading FX.

**TRADING STRATEGIES**

FX Engines advocates a sophisticated approach to trading the news, using time-tested methods for position sizing, entry, and exit.

- ✓ **Position Sizing** – A simple fixed-fractional method of position sizing is an excellent foundational money management approach. You select the equity exposure fraction for each trade and set your systems accordingly. If you have a standard account with \$100,000 and you wish to risk 2% using a news system that risks 10 pips per trade, you can trade 20 standard contracts. At that level, your total loss risk is \$2,000, and your potential gain is easily far beyond that.
- ✓ **Trade Entry** – FX Engines has developed price spike sensing signals of varying speeds to put you in the market during news events, in the direction of the spike. Which speed of entry you employ depends on how committed you are to the trade. If you believe the trade will have little volatility you could choose to employ the fast signal, or you could go to the other end of the spectrum and use the

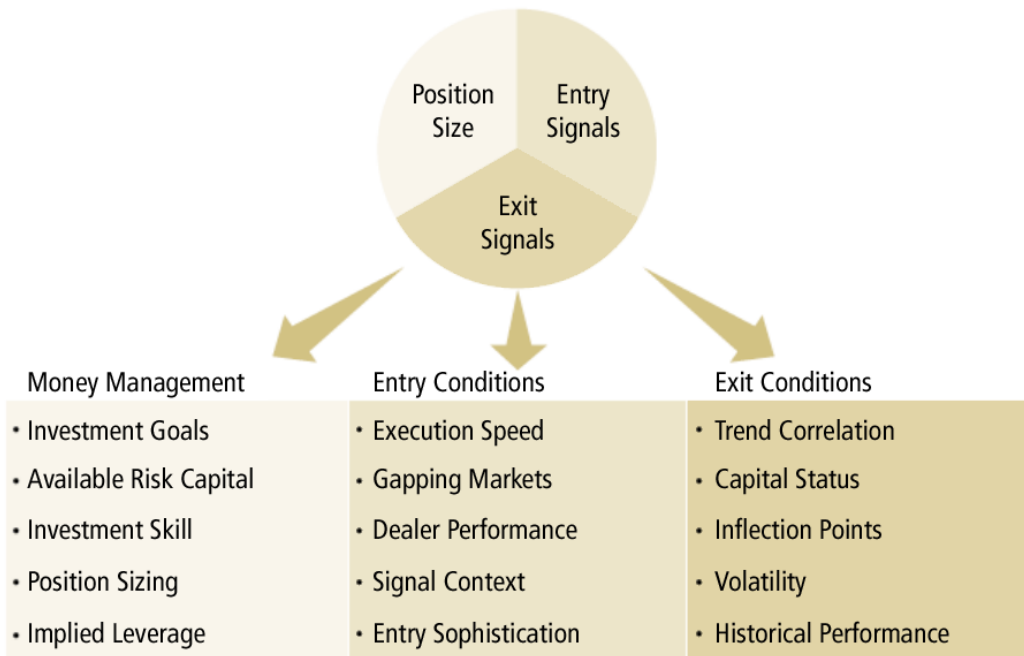
slow signal as a conservative option. Both will put you in at the *beginning* of a spike. To make your approach even more sophisticated, create multiple entries using a variety of signals to 'blend' your entry into a risk-adjusted group of positions.

- ✓ Trade Exit – With FX Engines you can create sophisticated exit strategies that use multi-layered trailing stops, exit signals, or both. Additionally, you can change the exit strategy for an ongoing trade at any time, replacing it with another fully automated exit system. As in entries, we recommend using a blended approach to exits, taking profits early on part of the position, protecting profits with an opening to a better gain on others, and swinging for the fences on the remainder.

As Figure 5 shows, these three trade strategy variables require a personal evaluation from each trader based on at-risk capital and trading goals.

**Figure 1: Elements of a Trade**

Preparing to trade requires a thorough examination of your money management approach, your entry system, and you exit strategy.



## **SAMPLE TRADES**

Trading the news is not without risk, and there will be occasions when a price spike has a quick reversal, or prices will move quickly against an established position. However, the data simply does not show that as the normal case. Our review of trades for the past 5 years shows that price spikes driven by news are far more likely to continue to solid gains than to reverse. Additionally, FX Engines gives you the tools you need to manage all possible outcomes and still come out with a winning trade.

The sample trades included here all show positive trades, but keep in mind that trading the news will not result in a 100% success rate. This strategy is excellent because it is not prone to large, consecutive losses and one gain can usually erase a number of losses. As with any new trading method, we advise practice with a FX Engines free demo account before live trading.

On the following pages are five recent events that highlight the power of trading the news, along with sample risk/return information. Remember, data like this is included in all Event Reports from FX Engines in even greater detail, sent to you the day before a news event.

About the sample trades shown on pages 12-16:

Hypothetical performance results have many inherent limitations. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. In fact, there are frequently sharp differences between hypothetical performance results and the actual results subsequently achieved by any particular trading program. One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk. Variables such as the ability to adhere to a particular trading program in spite of trading losses as well as maintaining adequate liquidity are material points which can adversely affect actual real trading results. Past results are not necessarily indicative of future results.

*February 28, 2006, 10:00:00 AM EST*  
**Consumer Confidence**



*Summary*

Following the Consumer Confidence report EUR surged 45 pips within 30 minutes. This trade was a pure spike with price never falling below the open at the time of the report.

	<b>1% Position</b>	<b>2.5% Position</b>	<b>5% Position</b>
Balance	\$100,000	\$100,000	\$100,000
At-Risk	\$1,000	\$2,500	\$5,000
Stop Loss	15 pips	15 pips	15 pips
Contracts	6 (100K)	16 (100K)	33 (100K)
Potential Profit	45 pips	45 pips	45 pips
Potential Gain	\$2,700	\$7,200	\$14,850
Potential Return	2.7%	7.2%	14.8%

**March 3, 2006, 10:00:00 AM EST**  
**ISM Services**



**Summary**

This trade was a pure short spike following the report on ISM Services productivity. Note that the move was just 25 pips, but still highly profitable.

	<b>1% Position</b>	<b>2.5% Position</b>	<b>5% Position</b>
Balance	\$100,000	\$100,000	\$100,000
At-Risk	\$1,000	\$2,500	\$5,000
Stop Loss	15 pips	15 pips	15 pips
Contracts	6 (100K)	16 (100K)	33 (100K)
Potential Profit	25 pips	25 pips	25 pips
Potential Gain	\$1,500	\$4,000	\$8,250
Potential Return	1.5%	4.0%	8.25%

*April 27, 2006, 10:00:00 AM EST*  
**Fed Congressional Testimony**



**Summary**

This trade came immediately after Ben Bernanke announced the Fed's plans for future rate increases. Price shot up nearly 80 pips immediately, and sustained from there. This trade was a major force in the continuation of a significant EUR long trend.

	<b>1% Position</b>	<b>2.5% Position</b>	<b>5% Position</b>
Balance	\$100,000	\$100,000	\$100,000
At-Risk	\$1,000	\$2,500	\$5,000
Stop Loss	15 pips	15 pips	15 pips
Contracts	6 (100K)	16 (100K)	33 (100K)
Potential Profit	115 pips	115 pips	115 pips
Potential Gain	\$6,900	\$18,400	\$37,950
Potential Return	6.9%	18.4%	37.9%

*May 4, 2005, 8:30:00 AM EST*  
**Initial Jobless Claims**



*Summary*

This trade did not follow a single spike trajectory, but smoothly made a positive run up 100 pips over a few hours. Notice that a stop 15 pips from the open would have held comfortably.

	<b>1% Position</b>	<b>2.5% Position</b>	<b>5% Position</b>
Balance	\$100,000	\$100,000	\$100,000
At-Risk	\$1,000	\$2,500	\$5,000
Stop Loss	15 pips	15 pips	15 pips
Contracts	6 (100K)	16 (100K)	33 (100K)
Potential Profit	100 pips	100 pips	100 pips
Potential Gain	\$6,000	\$16,000	\$33,000
Potential Return	6.0%	16.0%	33.0%

*May 5, 2005, 8:30:00 AM EST*  
**Nonfarm Payrolls**



*Summary*

Nonfarm Payrolls trades are some of the most volatile trades you will see. This trade had a very nice initial run that ended with a little retracement. It continued nicely in the next bar for a solid 80 pip gain.

	<b>1% Position</b>	<b>2.5% Position</b>	<b>5% Position</b>
Balance	\$100,000	\$100,000	\$100,000
At-Risk	\$1,000	\$2,500	\$5,000
Stop Loss	15 pips	15 pips	15 pips
Contracts	6 (100K)	16 (100K)	33 (100K)
Potential Profit	80 pips	80 pips	80 pips
Potential Gain	\$4,800	\$12,800	\$26,400
Potential Return	4.8%	12.8%	26.4%

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## ACTION

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Trade the news with FX Engines! The tools, data, and technology you need to trade FX strategically – conservatively using leverage – are now available to you.

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### **YOUR TRADE THE NEWS TOOLKIT**

FX Engines is the only trading platform built around trading the news. Our feature set and internal expertise can arm you for trading success, and we make it easy with our no-worry fee structure - no fees! You pay only the standard bid-ask spread, and with your live account you have unlimited access to all of the information and expertise we have to offer:

#### **INSTANT EXECUTION\***

Trading the news presents an incredible opportunity but requires a unique, news-specific toolkit. At FX Engines, it starts with order execution in milliseconds\*, faster than any manual execution. Our instant execution\* of orders gives traders the edge they need to trade the news successfully.

#### **AUTOMATED TOOLS**

Along with our execution speed, our automation system stands at the forefront of the tools needed to trade the news effectively. Very simply, price action from news usually happens too quickly for a human to see, process, and act upon before the market has passed. FX Engines enables instant decision making to go with instant execution\*, fueling your news strategies.

#### **READY-MADE SYSTEMS**

Even if you don't have experience placing orders for trades, you can still trade the news. FX Engines offers a wide variety of ready-made trading systems that put you in the market at the right time and allow you to control when to exit. You can set specific profit goals or let a trailing stop collect profits as the position improves - all for no extra cost beyond the bid/ask spread.

\*Under normal market conditions.



## ***AUTOMATED NEWS SIGNALS***

For a truly custom approach, use FX Engines' custom news signals to create your own orders with custom exits, timing and more. Our signals were designed to sense news related price action and enter at one of a handful of predetermined levels. You simply select the signal, specify the exit, and schedule the trade.



## ***IN-DEPTH EVENT REPORTS***

We've studied the price action of news events in great detail, and we make that wealth of information available to you. Each week before a news release we'll highlight that data in an Event Report, with specific historical price patterns and tips for what to expect - a resource you won't get anywhere else.

FX Engines offers a free, unlimited trial of its state-of-the-art trading platform. Simply go to [www.fxengines.com/register](http://www.fxengines.com/register), complete the form, and you can begin demo trading immediately. You'll have the same access to the weekly and daily Event Reports that live traders get, and you'll be able to demo trade for free as long as you wish.

When you're ready to go live, go to [www.fxengines.com/newaccounts](http://www.fxengines.com/newaccounts) to create a new trading account with our dealer. If you have any questions along the way, log in to the site and click support to send us a message.

Best wishes in all of your trades!

## MANAGED ACCOUNTS

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For those of you who wish to take advantage of trading the news but prefer a managed solution, check out the FX Investor offering from FX Engines. We offer a wide array of fully managed news trading solutions with real time updates of account activity. Email [sales@fxengines.com](mailto:sales@fxengines.com) for more information.

## MORE INFORMATION

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For more information about The Forex Report, visit [www.fxengines.com](http://www.fxengines.com) or email [info@fxengines.com](mailto:info@fxengines.com). The Forex Report is available for distribution on third party websites as a co-branded offering. Contact us for more information.

## THE FOREX REPORT

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Analyzing statistical, econometric, and behavioral trends in the foreign exchange markets for insight into the optimal use of the FX Engines automated trading platform.

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The information contained in this report is represented without warranty or any statement of its veracity. The contents of this report are intended to stimulate thinking on issues related to trading forex. This report does not suggest any particular action that could be utilized in live trading for profit or loss.

I can put it no better than Hoffer, who deferred to Montaigne:

“All I say is by way of discourse, and nothing by way of advice. I should not speak so boldly if it were my due to be believed.”