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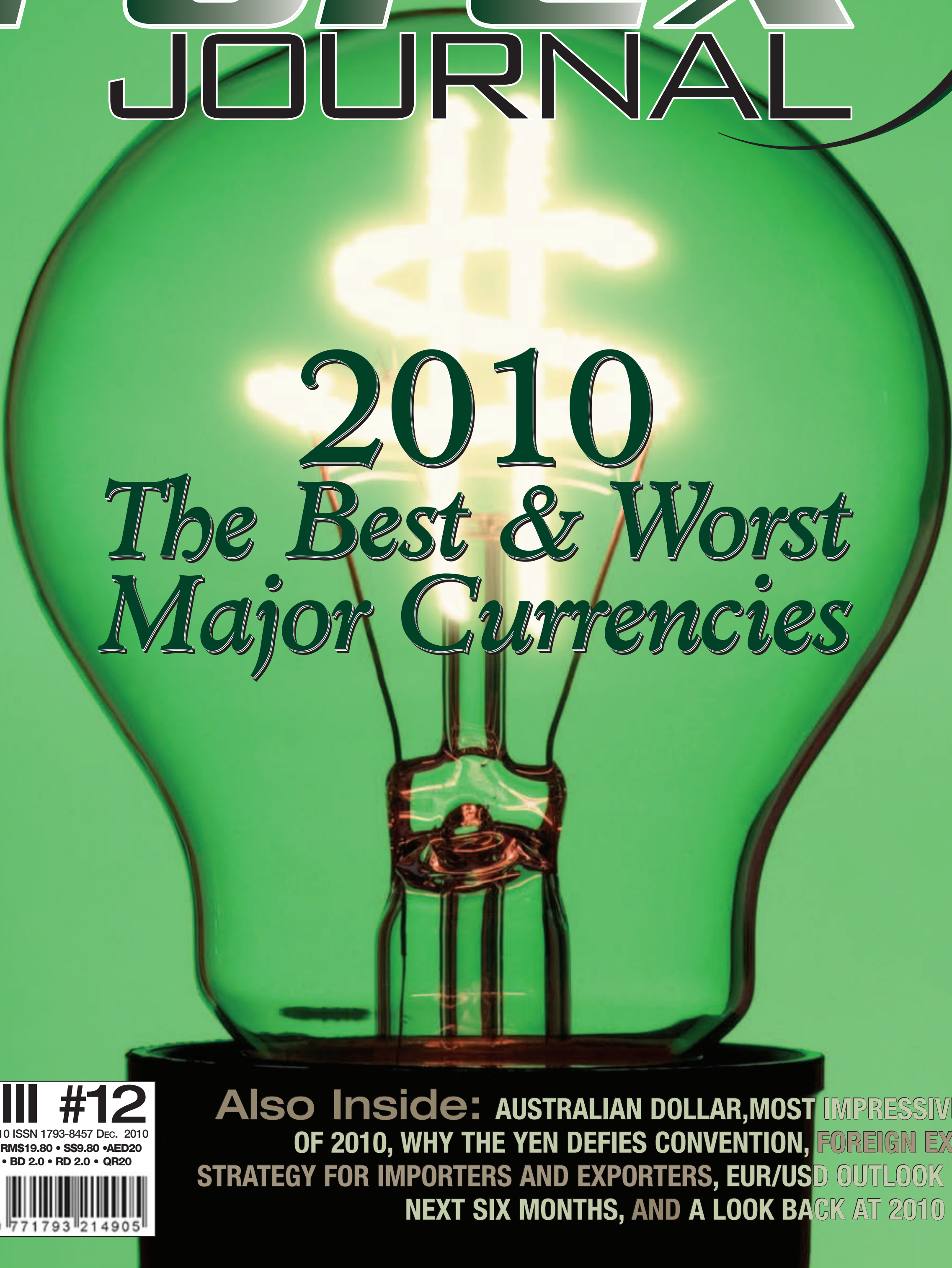

2010 The Best & Worst Major Currencies

Vol III #12

MICA (P) 012/07/2010 ISSN 1793-8457 Dec. 2010

A$9.95 • HK$68 • RM$19.80 • S$9.80 •AED20 • KD2.0 • SR 20 • BD 2.0 • RD 2.0 • QR20

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Also Inside: AUSTRALIAN DOLLAR,MOST IMPRESSIVE TRADE OF 2010, WHY THE YEN DEFIES CONVENTION, FOREIGN EXCHANGE STRATEGY FOR IMPORTERS AND EXPORTERS, EUR/USD OUTLOOK FOR THE NEXT SIX MONTHS, AND A LOOK BACK AT 2010 FOREX...

Foreign Exchange Strategy for Importers and Exporters

Not all players in the Forex markets are speculative traders. There are many who are trying to reduce currency risk and looking for a stable hedge strategy. Ron Schelling shows how using Forex to hedge currency transactions can save money.

When engaging in international trade, many companies that operate using U.S. dollars negotiate all agreements in U.S. dollars (USD). By purchasing / selling goods in U.S. dollars versus local currency, companies believe they effectively eliminate their exposure to foreign exchange rate volatility. However, this assumption is a common misconception. Foreign exchange risk is inherent in all cross-border activity. As such, a firm can have no foreign currency cash flows and still have economic exposure to exchange rate movements. By negotiating all agreements in U.S. dollars, U.S. companies increasingly place themselves at a competitive disadvantage relative to those companies that deal in foreign currency.

TEXT **RON SCHELLING**

"Foreign exchange risk is inherent in all cross-border activity. As such, a firm can have no foreign currency cash flows and still have economic exposure to exchange rate movements. By negotiating all agreements in U.S. dollars, U.S. companies increasingly place themselves at a competitive disadvantage relative to those companies that deal in foreign currency."

There are several disadvantages to doing business abroad for corporations that operate using the U.S. dollar.

IMPORTING:

- *Paying inflated prices – the local bank may charge excess premiums to convert U.S. dollars into the local currency and the vendor will receive less local currency when converted.*

- *Loss of control of exchange rate risk – if the U.S. dollar falls in value against the foreign currency, dollar payments will increase.*

- *Risk of payment delays – U.S. dollar wires sent internationally can take 3 to 5 business days to be received by the vendor. Payments made in the local currency can be delivered same day in some cases.*

EXPORTING:

- *Lost sales opportunities – export firm's customers may choose a competitor's substitute product because it is priced in the local currency*

- *Risk of payment delays – if the dollar strengthens significantly against a customer's home currency, the customer may be more inclined to wait for the exchange rate to improve in their favor before sending a U.S. dollar payment*

WEAK U.S. DOLLAR

Exporters who receive Forex payments

Foreign currency receivables convert to more dollars:

Risk Management Advantage:

Hedge strategy may increase profit margin

Competitive Advantage:

Hedge strategy may allow U.S. dollar companies to undercut competitors, who price in U.S. dollars and gain market share

Importers who pay through Forex

Foreign currency payables convert to more dollars:

Risk Management Advantage:

Hedge to lock in the cost of goods purchased and to protect profit margin

Competitive Advantage:

Transparent vendor pricing and avoidance of paying excessive risk premium

STRONG U.S. DOLLAR

Exporters who receive Forex payments

Foreign currency receivables convert to fewer dollars:

Risk Management Advantage:

Hedge to control profit margin

Competitive Advantage:

Hedge to hold prices constant and maintain market share

Importers who pay using Forex

Foreign currency payables convert to fewer dollars:

Risk Management Advantage:

Hedge strategy may decrease cost of goods purchased and increase profit margins

Competitive Advantage:

Opportunity to undercut competitor's prices and to gain market share

USING FOREIGN EXCHANGE STRATEGIES HELPS TO:

- *Lock in exchange rates – on the day a foreign payment is made, the client knows the exact cost in U.S. dollars and is protected against loss from fluctuating rates.*

- *Avoid hidden expenses – the client can eliminate the hidden costs and market-fluctuation markups that can accompany foreign bills or invoices quoted in U.S. dollars. Ask for the foreign currency and U.S. dollar payment amounts to see your potential savings.*

- *Make timely and secure payments – international payments are sent to the designated foreign bank within two business days. The U.S. equivalent is deducted from the clients' account on the day the request is made and the currency payment is sent to the designated foreign bank.*

PRACTICAL USE

Situation – Company A has a foreign invoice of £1MM and decides to pay in U.S. dollars. Company B also has a £1MM invoice but decides to pay in local currency. *(con't page 53)*

Commodity prices sky- rocketed during 2009 and continue in 2010 primarily because of the input of $2 trillion into the economy by the Federal Reserve. In addition, crop failures were prevalent on world wide basis. Corn, wheat, canola, rice and soybeans all experienced severe weather problems reducing supply a great deal. It was not uncommon for price advances between 20 and 60% in these commodities.

This phenomenon could be expressed by watching the Australian dollar as it has a nearly 90% correlation with commodity prices. As can be seen by the enclosed chart, prices of soybeans and cotton had a near one hundred percent correlation with the Australian dollar. The Canadian dollar also has a strong correlation but it was more related to the precious metals. This is important to Forex traders because currency values are affected by the supply and demand of the raw products these countries produce.

If demand slows, the flow of money will slow as well. And if demand picks up, the flow of money will increase. Everyone thinks that China is going to buy everything that is grown or taken out of the ground. The Chinese also experience the same type of domestic supply / demand situations that we in the rest of the world experience. The difference lies in the fact that reporting from Chinese economists is not always as it appears. This is why learning to read chart patterns is very important when trading Forex whether it is daily, hourly or five-minute charts. TFJ

Larry Pesavento is a 45-year veteran trader. He began his career trading full time in 1967 while in graduate school earning an MBA in Finance following a Bachelor of Science in Pharmacy. He managed the commodities department of Drexel Burnham Lambert in Southern California from 1976 to 1981. In 1982, he became a member of the Chicago Mercantile Exchange where was a local in the S&P and currency pits.

Following this, he worked for a Commodity Corporation in Princeton, New Jersey from 1985 to 1986 and in 1987 he wrote Astro Cycles – The Traders Viewpoint and published a newsletter called "Astro Cycles" until 1995. Currently, he resides in Tucson, Arizona. He has spent the last decade working on artificial intelligence i.e. neural networks and genetic algorithms. Using this technology, he is working to develop an automatic trading system.

He has an extensive library on the subject of technical analysis and has trained over 1000 traders using the pattern recognition swing trading methodology described in his books. Over the past 25 years, he has written 10 books on trading. He can reached at www.tradingtutor.com.

Company A – Sends U.S. $

DAY 1:

Client asks the bank for an approximate GBP/USD £1 MM rate for GBP
The bank quotes a USD cost of $1.6050 per Pound Sterling
Client initiates a USD transfer for beneficiary's account at Bank B.
Cost is $1,605,000
The Bank processes the U.S. dollar transfer

DAY 2:

Bank B receives $1,605,000 and gives it to their Forex department.
USD weakens versus GBP. GBP/USD rate is now $1.6200
Value of $1,605,000 translates to £990,740

DAY 3:

Beneficiary is credited for £990,740. There is an underpayment of £9,260 or $15. 000. The client must send a second transfer to make up for the shortfall due to the currency fluctuation and the fees and rate charged by Bank B.

Company B – Sends GBP

DAY 1:

Client asks the Bank to send £1MM to beneficiary's account at Bank B.
The Bank quotes a U.S. dollar cost of $1. 6050
The Bank processes the foreign exchange transfer at a USD cost of $1,605.000

DAY 2:

USD weakens overnight to $1.6200. But this change in rate does not affect the client's transfer because the Bank rate is locked in

DAY 3:

Bank B receives the £1,000,000 and can immediately credit the beneficiary's GBP account. The bill is paid in full.

By sending the payment in USD, Company A unnecessarily underpaid the bill making a second payment necessary. Consequently, the £1MM invoice cost Company B $15,000 more than Company B.

By sending the payment in the local currency, Company B locked the value of the USD in GBP terms eliminating the risk of overpayment or underpayment and ensuring that the bill was paid on time. TFJ

Ron Schelling is an independent trader in The Netherlands with over 25 years of experience in Forex, futures and arbitrage trading. He can be reached on www.2hedge.com.