



## Managing the Outlook for 2012

As we reach the close of 2011, some of the chatter I've run across is how to best position trading propositions for the upcoming year. Rather than devote an article towards speculation on fundamental perspectives in anticipation of potential economic impacts, the focus here will address examples of tools and strategies traders can use to manage their outlook.

Most who have followed previous articles I've written know that I use DiNapoli Levels as a means of technical analysis. Aside from trading outright contracts, I also use specific option strategies. That said, we'll take a quick look back at 2011 for FX with some examples on how certain strategies have played out and use the same context in evaluating considerations for the upcoming year.

To start, let's look at a previous chart earlier in the year 2011 where I'll define some parameters with the DiNapoli technical indicators towards formulating an outlook. Then, we'll look at a couple of strategies a trader could use to potentially manage that perspective. While the premise here uses historical data to form a trade bias, please reference the disclaimer at the end of the article as the content here is purely for educational purposes only and not a recommendation towards any investment decisions.

Looking below at the EUR/USD in 2011, I've included some technical analysis tools using DiNapoli Levels as a methodology to describe possible support / resistance levels using advanced Fibonacci. The areas labeled COP (blue), OP (green) and XOP (red) illustrate potential resistance levels as Fibonacci expansions forecasted after the level C (1.25875) on the weekly chart. Both the red (1.33634) and purple (1.27956) levels stemming from point A represent potential support levels as Fibonacci retracements, all using DiNapoli studies.

The red curved line is the DiNapoli MACD Predictor. I've illustrated this indicator with the standard DiNapoli MACD below. In a nutshell, when looking at the standard DiNapoli MACD indicator below, when the blue MACD line crosses above the purple signal line, it indicates a possible start of a trend and vice-versa. Having the red DiNapoli MACD Predictor line on the price chart in place of the standard MACD serves 2 purposes. It allows a trader to determine a specific price point at where crosses happen on the standard MACD and forecasts this value one time period ahead.

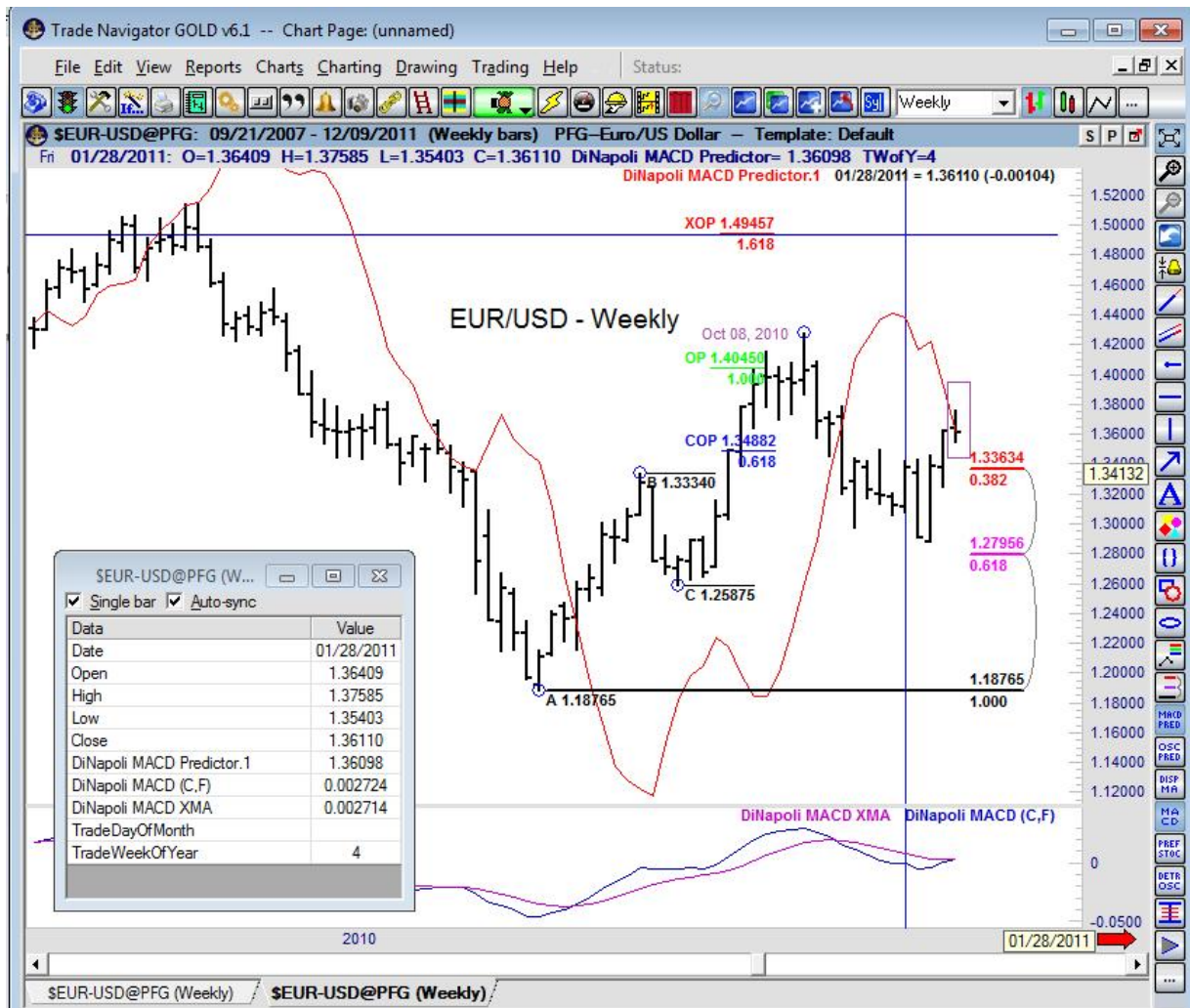
Let's consider 2 trade scenarios that will be referenced in the remainder of this article.

Looking at the info box, the MACD Predictor value is 1.36098 with the bar close above at 1.36110 indicating the start of a possible uptrend. Let's use this as the premise of our Outlook with a bullish perspective. If price moved and held below the predictor value (red line), we would assume we were incorrect. Scenario #1, how would you form a trade to match this outlook?

Let's consider a different scenario. Referencing the same chart below, look at the green OP (1.4845) level of resistance (forecasted from point C where price stalled before the retracement). Given the consolidation, how would you have realistically managed that outlook in hindsight? Scenario #2, is there a way to earn on a trade given a sideways market?

One of the biggest challenges on trading higher time frames is obviously managing the risk one takes while waiting for a given outlook to play out amidst emotions in watching the account draw down.

# Managing the Outlook for 2012



\* chart illustration with TradeNavigator by GenesisFT

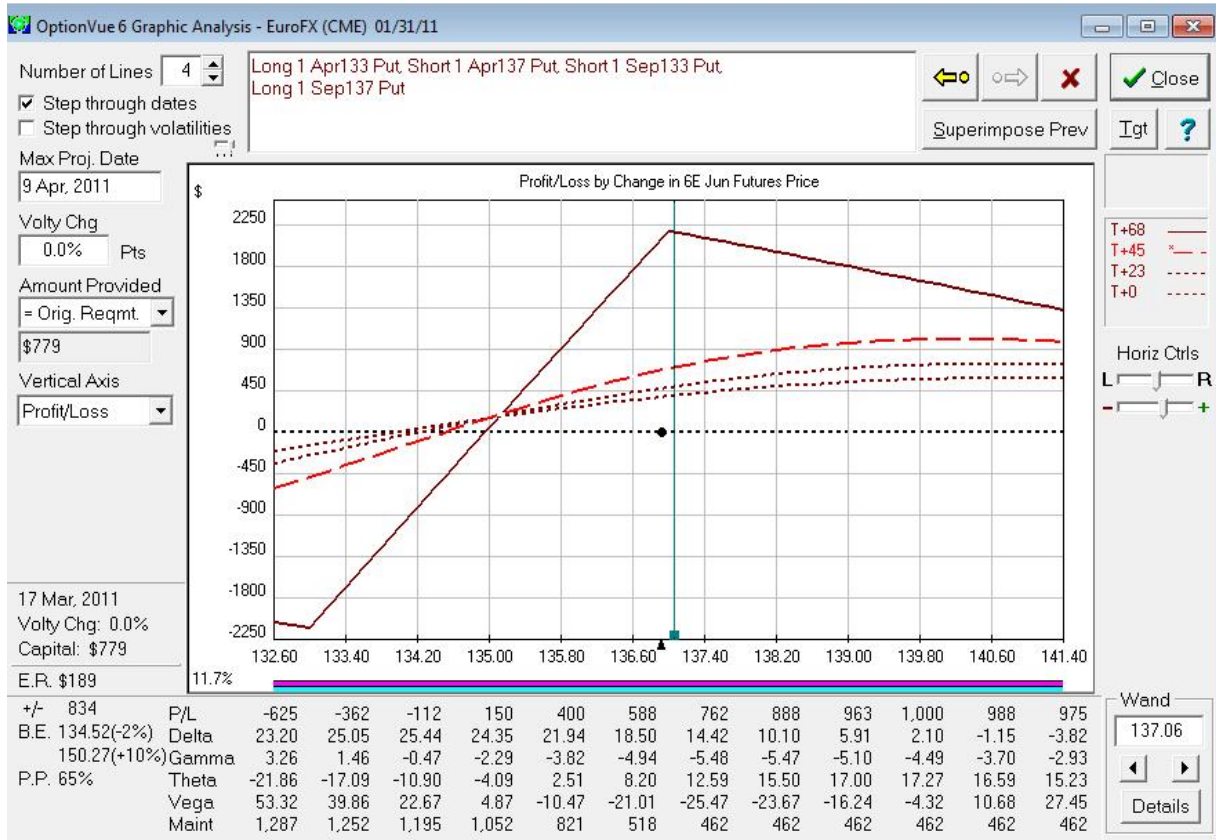
Let's go to the question for Scenario #1 above and assume our outlook is bullish with price at the start of a possible trend in its move above the DiNapoli MACD predictor. Given the weekly time frame, I'm selecting 2 targets assuming a continuation bullish with the first target at prior consolidation (near the OP 1.40450 level (green) prior consolidation). The second target would be the higher forecasted XOP level (red) of resistance. In this simplified example, suppose we manage risk by exiting the trade if we're wrong using a percentage of the daily ATR (average true range with a value of 120 pips). We can achieve this by dropping time frames, part of a combination of techniques taught in advanced DiNapoli seminars.

From our strategy above, it comes down to selecting your instrument of choice. If you decided to purchase a 1 lot on spotFX (~100K), given the outlook on a high time frame, the potential account risk on drawdown would be close to \$1,200 (assuming 120 pips @ \$10/pip). It'd be slightly more on FX futures (\$12.50 / pip). On FX futures, margin on a 1 lot would be approximately \$2,500. Most traders seldom

# Managing the Outlook for 2012

have the patience or emotional endurance in waiting for the strategy to play out trading outright contracts with possible large drawdown on their account.

From a different perspective, if we were to consider options on the Euro currency to manage the trade outlook, below outlines a “calendar swap” strategy using put options. On a side note, it just takes traders getting used to the quote conventions of different platforms. So, on the illustration below, just move the decimal 2 places to the left where 137.00 simply reads as 1.3700.



\* chart illustration with OptionVue software

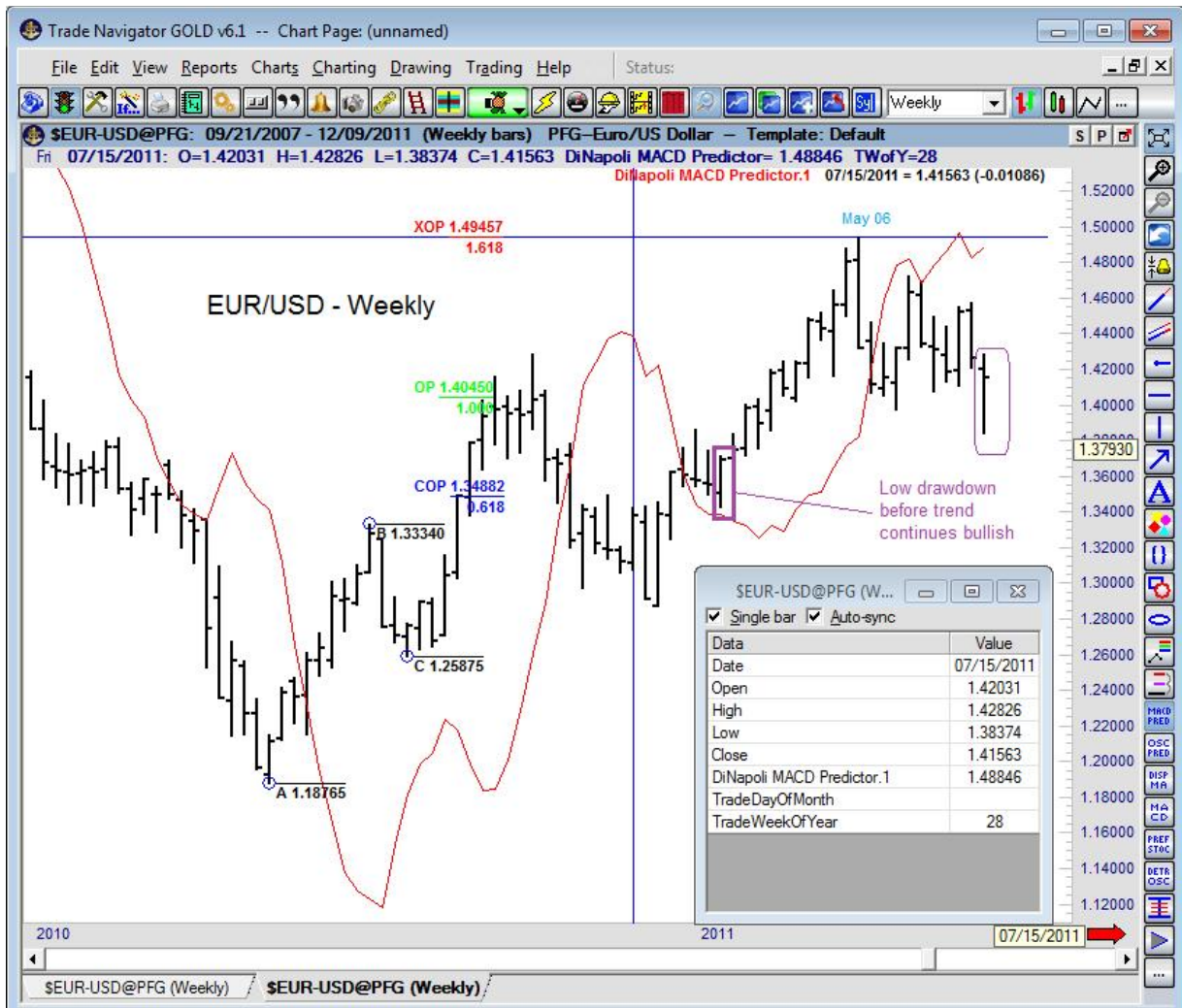
Interpreting the chart above, the upper right reading T+45 simply shows the scenario if we were to execute this particular option strategy and hold it for 45 days. We can see if price remained near the 1.3660 level, a profit (row labeled P/L) of approximately \$588 could be realized. The margin to put on this trade is much lower at \$779 as a capital outlay versus obtaining a 1 lot of the underlying. (*\* Note although the “Greeks” aren’t discussed here for simplicity, those who understand options will appreciate Vega is minimized by this trade structure for a more directional play not largely impacted by implied volatility.*)

More importantly in referring back to our original outlook on scenario #1 above, weathering even a 280 pip draw down from say 1.3700 to 1.3420 shows a palatable draw down of (\$112) per spread versus what we considered earlier in excess of (\$1,200) on trading 1 lot of spotFX.

## Managing the Outlook for 2012

The point I'm trying to make here is that aside from managing your outlook with a given framework of technical analysis, there should be specific strategies in place thought well in advance in terms of how a trader will manage risk on any financial instrument.

The illustration below in hindsight shows where the outlook turned out with trend continuing to meet resistance defined at the XOP (1.49457 red line). However, how many would have been able to weather the drawdown to a low of 1.3428 trading the outright contract before the trend continued?

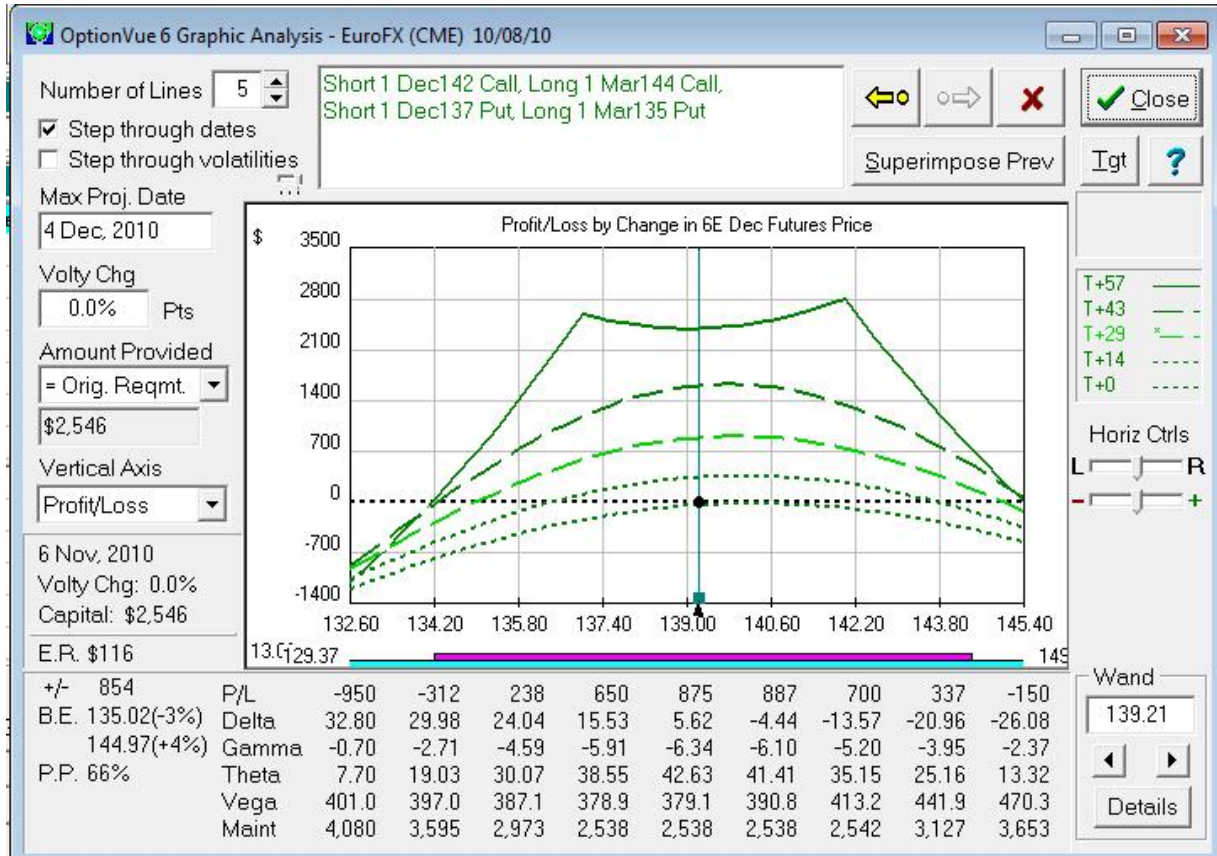


Referencing Scenario #2 where price stalled at the OP (1.40450 green) level and your outlook was neutral in anticipation of a sideways market in hindsight, how could this have been played? Below is an example of trade structure called a strangle swap which is designed to earn positive time decay each day from the sale of options while taking advantage of market implied volatility rather than price moves. It's designed to be held 29 days in this example with a minimal profit target of around \$800 over \$2,546 margin or around 31%. The column where the vertical line intersects the value for a Vega reading of 379.10 means that for every 1 point increase of implied volatility, the profit level would increase by approximately \$379. This would be on top of the \$800 described above.

For more information, visit us at: [www.oahucapital.com](http://www.oahucapital.com) | Education at: [www.hawaii forex.com](http://www.hawaii forex.com)

## Managing the Outlook for 2012

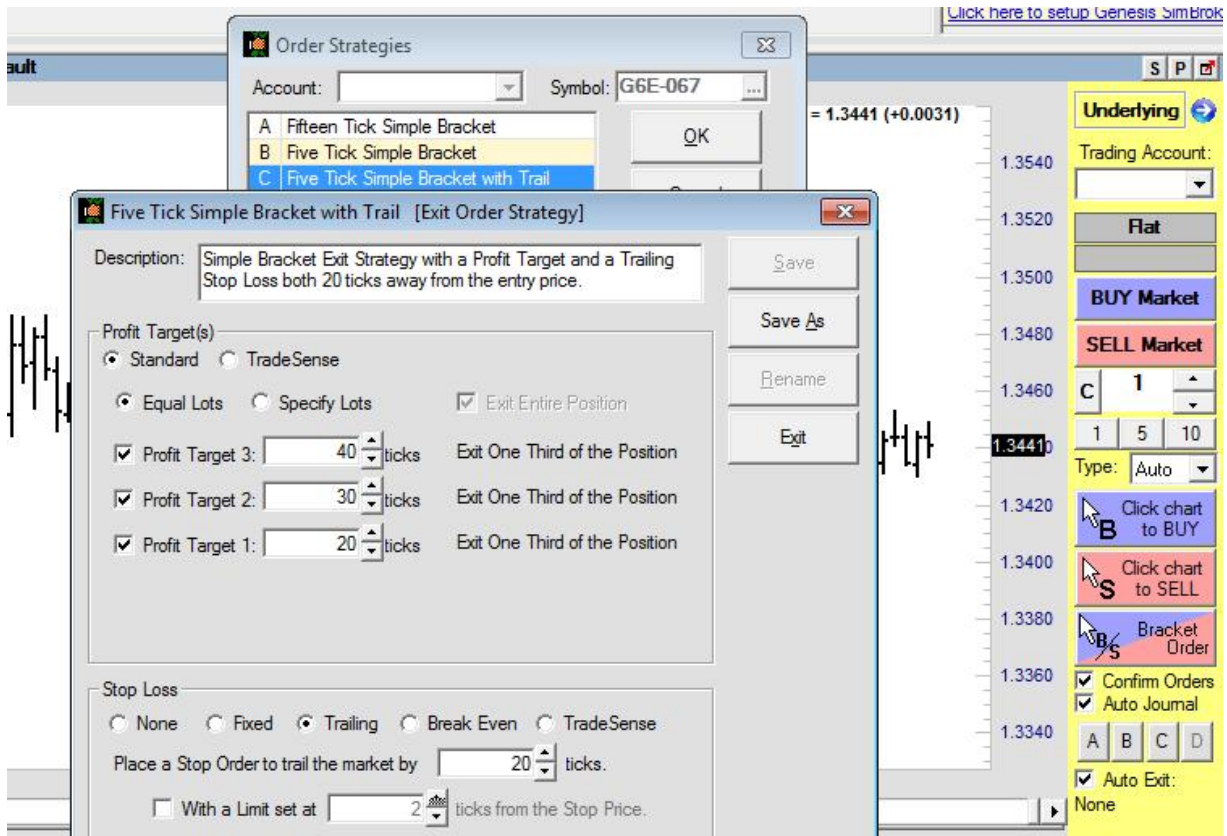
Considering the potential return on margin if the trade is favorable, it is an attractive play in a sideways market.



Here, so long as price chops between the range of 1.3740 to 1.4220, the trade structure earns profits. It would lose if price exceeded the range in which case the trader would possibly look to make an adjustment or close out entirely. It's designed to earn over time on a sideways market.

Again, the point being made here is that the snapshot of each scenario has a trade plan to manage a specific outlook relative to its associated risk level. Whether a trader decides to use financial instruments in a way that takes advantage of longer time frames as illustrated here or more sophisticated platforms as shown below to take advantage of intraday plays, many different plans can be created to match their outlook.

## Managing the Outlook for 2012

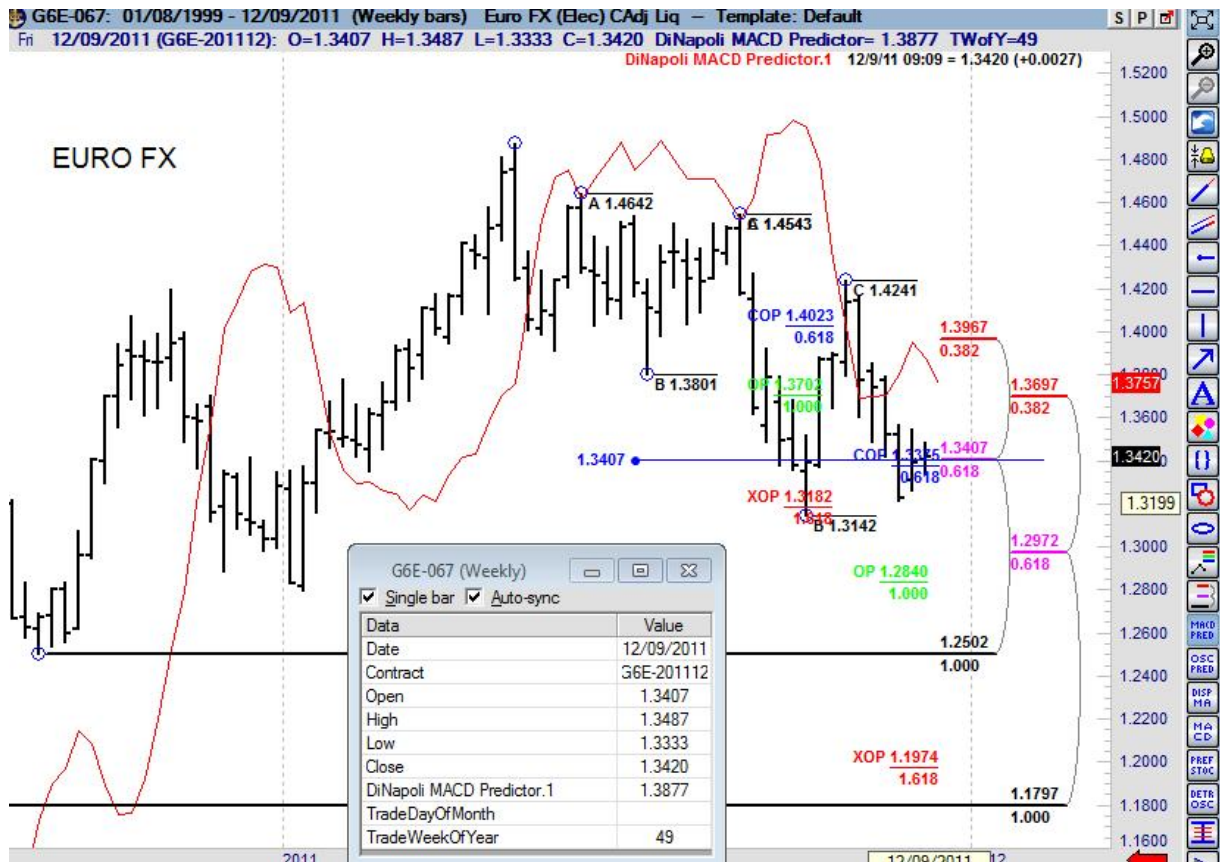


\* illustration with TradeNavigator by GenesisFT

So, let's move forward into 2012 . . .

As of this writing, and using DiNapoli Levels as the base of technical analysis, the EUR/USD has moved its way into a downtrend with prior support at the 1.3407 level as illustrated below which was forecasted using the DiNapoli Fibonacci retracement study.

## Managing the Outlook for 2012



Using similar trade structures described earlier, from a long term perspective, a bearish outlook could be maintained with a calendar swap using call options with prior support adjusting to newly found resistance. Or, anticipation of a sideways market could be structured as a “delta neutral” volatility trade to take advantage of earning positive time decay as described in the strangle swap above.

One trader’s outlook will obviously be different from another. Factor in an endless array of variables to include time frames, different financial instruments, technical & fundamental strategies, etc. and the array of options a trader has towards managing his outlook on any given market is endless. My belief is that something can always be managed with the right tools and knowledge at hand. It’s just a matter of finding those tools which match the same elements that make you tick as a trader.

For more information on DiNapoli Levels as a technical methodology, options, managed programs or brokerage, feel free to contact me at: [Derek@oahucapital.com](mailto:Derek@oahucapital.com)

*Derek Ching is an active trader and DiNapoli Expert employing technical strategies with DiNapoli Levels, a sophisticated form of Fibonacci techniques. Using DiNapoli levels and option strategies in analyzing markets, he writes commentary for online trade publications in addition to being a regular contributor to several active trading communities with DLevels forward analysis.*

*He maintains a Series 3 & 30 license as a registered IB (futures broker with Oahu Capital) and NFA member (National Futures Association). He actively trades futures, options foreign exchange aside from organizing education for professional traders.*

For more information, visit us at: [www.oahucapital.com](http://www.oahucapital.com) | Education at: [www.hawaiiiforex.com](http://www.hawaiiiforex.com)

## Managing the Outlook for 2012

*As managing director for Oahu Capital, he is currently working with Oahu Capital offering brokerage for commodity futures, options and fx. He provides guidance on technical strategies using DiNapoli Levels and option strategies.*

*Disclaimer: Trading Forex (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.*