

Looking at the open positions.....

Whilst discussing the recent price action on the Euro with traders in our trading room, some asked if I could write down what I had described and so here's the article.

Prior to last week's FOMC (18th Sept 2013) I noticed that there were a high percentage of open short positions on the Euro. You can obtain this information from our website. Just go to 'resources' then 'Forex order book'.

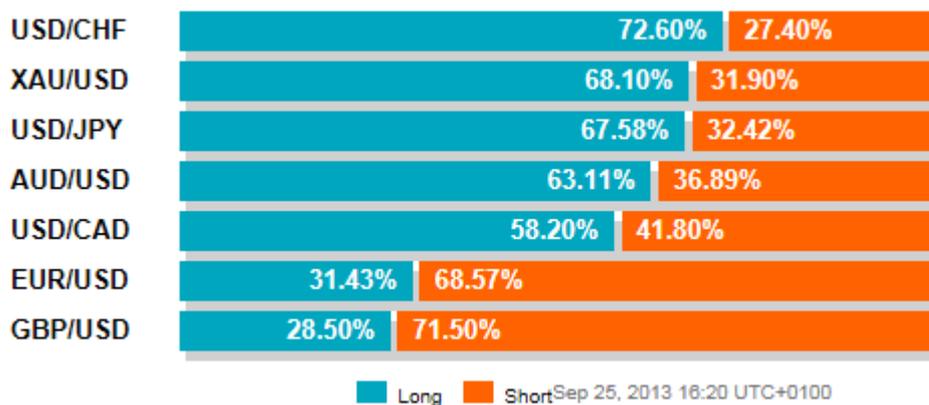
Then after the big spike up in the Euro (see 4hour chart below), I noticed that the percentage of retail traders who were short was still up well over 70%.



On the chart above I have placed an arrow pointing to where the Euro shot up to after the FOMC meeting and then circled the subsequent 4 day consolidation. I placed another red

horizontal line that shows the price level at which over 70% of retail traders were already short (ouch). So even after the Euro shot up from the 1.3350 area to 1.3550 area, over 70% of traders were still short.

Below is a screenshot of what the FX open positions table looks like on our site. As you can see, the Euro still has 68% of retail traders being short even after this 4 day consolidation. And the pound has even more! What gets really interesting is what happens next...



So I will ignore the pound and stick with the Euro but essentially it is the same thing happening. As per the chart above, retail traders thought the Euro was going to come down and thus have been shorting it prior to and after the FOMC. When a high percentage of retail traders are collectively on one side of the market such as this, very often (although not always) they will be wrong.

Why they are often wrong is something worthy of a future article but at this stage what do they want? Well they need the Euro to come down and to come down by quite a lot by the looks of it.

Now let's go into the basics of price movement. If a market is accelerating higher, it tells us there's heavy volume buying taking place. Only once a peak is made does it tell us that either buyers are drying up or that sufficient selling is happening in order to stop price moving any higher. Selling can come in the shape of short sellers entering the market or traders closing profitable long positions.

If price starts to consolidate near the highs as the Euro has on the chart above, it can mean one of two things; either institutional players are accumulating in order for the next run



higher or they are distributing, soaking up buy orders for a run lower. In this instance we have a large portion of retail traders who are stuck in short positions.

As we know, markets tend to gravitate towards where orders are stacked and in this instance, we know these short sellers stops are located above the recent highs. When a situation like this occurs, what's likely to happen is this; firstly, if the market comes down a little, some of the late short sellers may be able to exit their positions at break even or maybe a small profit. Looking at the chart above we can see that the Euro fell from an absolute high of 1.3567 to a low (thus far) of around 1.3465. So some traders may indeed have made a small profit depending on their entry but most won't have caught the absolute highs plus others may have exited on this down move on a small loss as they panic out as the market comes down.

Now what actually happens when a trader who is short decides to close their position? They have to buy in order to close the short trade. The traders who start closing short trades as the market consolidates are effectively helping to prop it up.

Also, if there's a stack load of buy stop orders above the current highs, if the market does indeed gravitate towards them, they can fuel another buying spree as buy stops are hit and that buying activity propels price yet higher still, thus creating the all important short covering rally.

In conclusion, when you see a heavily skewed Forex book with too many traders caught on the wrong side of the market, it's likely there's going to be more pain for many of them to come. Although this sounds harsh (it's simply what trading is) this creates an opportunity for you....

Charlie Burton