Lien, Kathy - The Little Book of Currency Trading

John Wiley & Sons, 2001, [Finance] Grade ★★★

This is partly an introduction to the foreign exchange (FX) market, partly a glance at a currency trader's strategy. Kathy Lien, today Director of Currency Research at Global Forex Trading, has a long history in FX from DailyFX.com and JP Morgan Chase. My major learning from the book is that though trading in FX is similar to trading in equities – it still isn't exactly the same.

Let's start with the differences. Most traders only trade the really liquid currencies such as the USD, the Yen, GBP, Swiss Francs plus Australian and Canadian Dollars. The currency pairs that these currencies make up can be traded 24 hours a day, during the full week. Currencies are more trending than many other assets and especially so in times of economic distress and large interest rate changes, hence the majority of investors are momentum investors – further strengthening the trends. Even though the technical analysis of FX-markets is similar to that of the equity market, volume indicators cannot be used due to the fact that the trading is done OTC and on top of that the time horizons, on average, are shorter because of the amounts of leverage used.

Now for the similarities: To cut losses quickly and let winners ride is by now almost a cliché but it is even more relevant for FX-traders as the momentum effects are stronger. Risk management is the key for survival. According to Lien you shouldn't risk more than 5 to 10 percent of your account on one trade (daring…). In terms of exit strategies stop-losses are almost universally used. In trading the concept of probabilities is crucial. Lien echoes the old trading advice to only put on trades with a 2-to-1 risk-reward-ratio, i.e. only do trades where you judge the upside to be twice as large as the potential downside. By this your hit-ratio doesn't have to be spectacular. Lien advices FX-traders to keep a trading log noting the basics of the trades plus your own comments on what went right or wrong. She further advices to find a time each week to review those trades and the

comments to try to spot how the process could be improved. However, only make changes in reaction to consistent, frequent mistakes.

Lien both day-trades on news and trades on medium term trends. I will leave the day-trading by, but the considerations she points to are fairly similar to trading on quarterly corporate earnings. The author's favourite tool in analysing the trend is double Bollinger bands. The two intervals are created by first calculating the 20 week rolling average of price movements and then create the first band 1 and 2 standard deviations above the average and the other in parallel below the average. When a currency pair is trending strongly they will keep within one of the bands. Exits could be made when prices exit the bands, but Lien instead uses a two tiered strategy where she first locks in some profits and then lets the remaining position run with a trailing stop-loss. I might be in over my head here but it strikes me as a perfectly reasonable strategy.

Lien appears to be a very energetic person and she has written two previous books on trading in the FX-markets. My guess is that those two might be better. This "little book" is neither a very thorough introduction of the market nor a sufficiently deep account of Liens trading practice. I would choose to focus more on the later as the author does have a lot of god advice to give. Not least do I appreciate her commenting on the importance of having the ability to distinguish between range bound markets and trending markets and of having the patience and psychological maturity to stay out of the first.

What is good with many of the books in the Little Book-series is that they are not merely short introductions to subjects on the financial markets; they are – when the format is at its best - the distillation of very seasoned persons hard won experiences in the market. This one has too much of a beginner's guide feel to it.

Mats Larsson, April 11, 2012