Currency Pairs and The Best Time To Trade Them

The foreign exchange market operates 24 hours a day and as a result it is impossible for a trader to track every single market movement and make an immediate response at all times. Timing is everything in currency trading. In order to devise an effective and time- efficient investment strategy , it is important to note the amount of market activity around the clock in order in maximize the number of trading opportunities during a trader's own market hours. Besides liquidity, a currency pair's trading range is also heavily dependent on geographical location and macroeconomic factors. Knowing what time of day a currency pair has the widest or narrowest trading range will undoubtedly help traders improve their investment utility due to better capital allocation. This article outlines the typical trading activity of major currency pairs in different time zones to see when they are most volatile. Table 5.1 tabulates the average pip range for the different currency pairs during various time frames between 2002 and 2004.

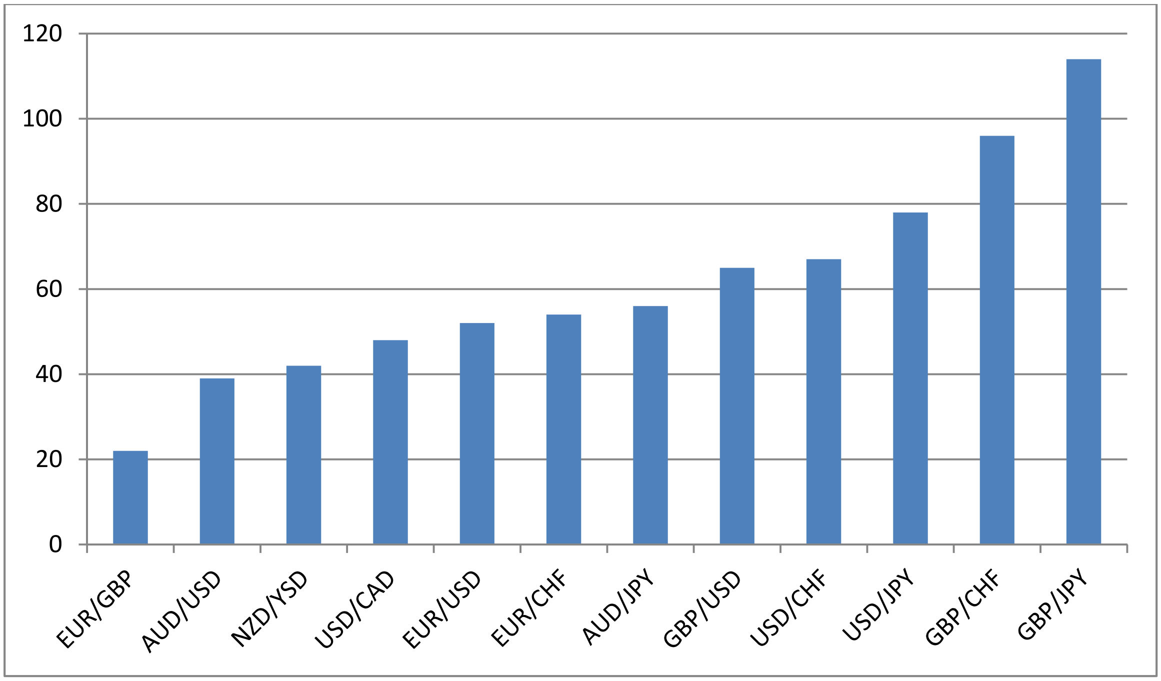
ASIAN SESSION (TOKYO): 7P.M.—4A.M. EST

FX trading in Asia is conducted in major regional financial hubs; during the Asian trading session, Tokyo takes the largest market share, followed by Hong Kong and Singapore. Despite the flagging influence of the Japanese central bank on the FX market, Tokyo remains one of the most important dealing centers in Asia. It is the first major Asian market to open, and many large participants often use their trade momentum there as the benchmark to gauge market dynamics as well as devise their market strategies. Trading in Tokyo can be thin from time to time; but large investment banks and hedge funds are known to try to use the Asian session to run important stop and option barrier levels. Figure 5.1 provides a ranking of the different currency pairs and their ranges during the Asian trading session.

For the more risk-tolerant traders, USD/JPY, GBP/CHF, and GBP/JPY are good picks because their broad ranges provide short term traders with lucrative profit potentials, averaging 90 pips. Foreign investment banks and institutional investors, which hold mostly dollar-dominated assets, generate a significant amount of USD/JPY transactions when they enter the Japanese equity and bond markets. Japan's central bank, with more than $800 billion of U.S. Treasury securities, also plays an influential role in affecting the supply and demand of USD/JPY through its open market operations. Last but not least, large Japanese exporters are known to use the Tokyo trading hours to repatriate their foreign earnings, heightening the fluctuation of the currency pair. GBP/CHF and GBP/JPY remain highly volatile as central bankers and large players start to scale themselves into positions in anticipation of the opening of the European session.

Table 5.1 Currency Pair Ranges					
Currency Pairs EST	Asian Session	European Session	U.S. Session	U.S. & European overlap	European & Asia overlap
	7P.M. – 4A.M.	2A.M.—12A.M.	8 A.M. – 5P.M.	8A.M. – 12P.M.	2A.M. – 4A.M.
EUR/USD	51	87	78	65	32
USD/JPY	78	79	69	58	29
GBP/USD	65	112	94	78	42
USD/CHF	68	117	107	88	43
EUR/CHF	53	53	49	40	24
AUD/USD	38	53	47	39	20
USD/CAD	47	94	84	74	28
NZD/USD	42	52	46	38	20
EUR/GBP	25	40	34	27	16
GBP/JPY	112	145	119	99	60
GBP/CHF	96	150	129	105	62
AUD/JPY	55	63	56	47	26

For the more risk-averse traders, AUD/JPY, GBP/USD, and USD/CHF are good choices because they allow medium term to long term traders to takes fundaments factors into account when making a decision. The moderate volatility of the currency pairs will help to shield traders and their investment strategies from being prone to irregular market movements due to intraday speculative trades. Below is Volatility Asian Market.

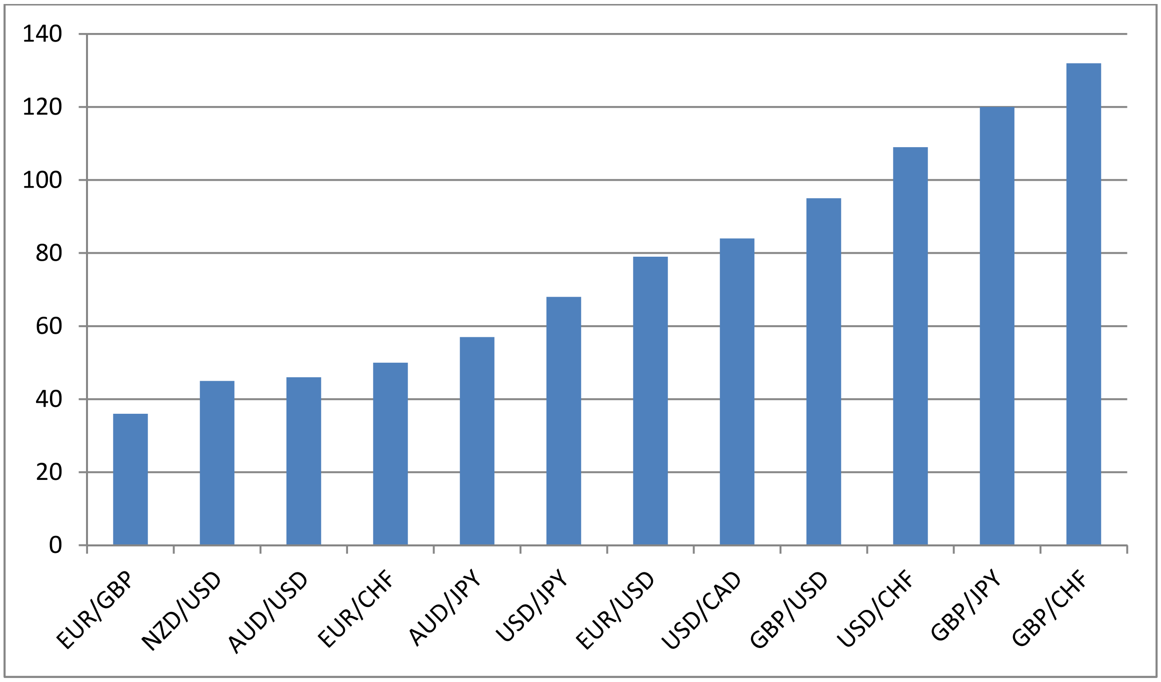


U.S. SESSION (NEW YORK) 8A.M. – 5P.M. EST

New York is the second largest FX marketplace, encompassing 10 percent of total FX market volume turnover according to the 2004 Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity in April 2004, published by the Bank for International Settlements (BIS). It is also the financial center that guards the back door of the world's FX market as trading activity usually winds down to a minimum from its afternoon session until the opening of the Tokyo market the next day. The majority of the transactions during the U.S. session are executed between 8a.m. and noon, a period with high liquidity because European traders are still in the market.

For more risk- tolerant traders, GBP/USD, USD/CHF, GBP/JPY, and GBP/CHF are good choices for day traders since the daily ranges average 120 pips. (See Figure 5.2) Trading activities in these currency pairs are particularly active because these transactions directly involve the U.S. dollar. When the U.S. equity and bond markets are open during the U.S. session, foreign investors have to convert their domestic currency, such as the Japanese yen, the euro, and the Swiss franc, into dollar dominated assets in order to carry out their transactions. With the market overlap GBP/JPY and GBP/CHF have the widest daily ranges.

TABLE 5.2 U.S Session Volatility



Most currencies in the FX market are quoted with the U.S. dollar as the base and primarily traded against it before translating into other currencies. In GBP/JPY case, for British pound to be converted into Japanese yen, it has to be traded against the dollar first, then into yen. Therefore, a GBP/JPY trade involves two different currency transactions, GBP/USD and USD/JPY, and its volatility is ultimately determined by the correlations of the two derived currency pairs. Since GBP/USD and UDP/JPY have negative correlations, which means their direction of movement is opposite of each other, the volatility of GBP/JPY is thus amplified. UDP/CHF movement can also be explained similarly but has a greater intensity. Trading currency pairs with high volatility can be lucrative, but it is also important to bear in mind that the risk involved is very high as well. Traders should continuously revise their strategies in response to market conditions because abrupt movements in exchange rates can easily stop out their trading orders of nullify their long-term strategies.

For the more risk-averse traders, USD/JPY, EUR/USE, and USD/CAD appear to be good choices since these pairs offer traders a decent amount of trading range to garner handsome profits with a smaller amount of risk. Their higher liquid nature allows an investor to secure profits or cut losses promptly and efficiently. The modest volatility of these pairs also provides a favorable environment for traders who want to pursue long-term strategies.

EUROPEAN SESSION (LONDON): 2A.M.—12P.M. EST

London is the largest and most important dealing center in the world; with a market share at more than 30% according to BIS survey. Most of the dealing desks of large banks are located in London; the majority of major FX transactions are completed during London hours due to the market's high liquidity and efficiency. The vast number of market participants and their high transaction values make London the most volatile FX market of all. As shown in Figure 5.3, half of the major 12 pairs surpass the 80 pips line, the benchmark that we used to identify volatile pairs with GBP/JPY and GBP/CHF reaching as high as 140 and 146 pips respectively.

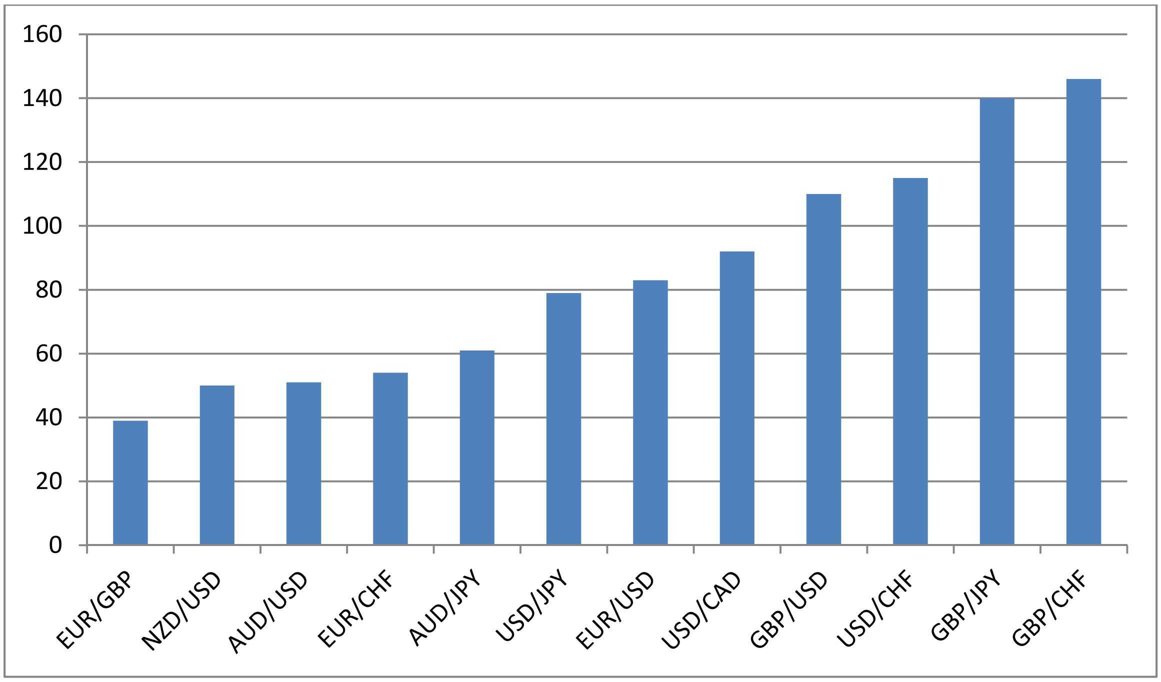


FIGURE 5.3 European Session Volatility

GBP/JPY and GBP/CHF are apt for the risk lovers. These two pairs have an average daily range of over 140 pips and can be used to generate a huge amount of profits in a short period of time. Such high volatility for the two pairs reflects the peak of daily trade activity as large participants are about to complete their cycle of currency conversions around the world. London hours are directly connected to both the U.S. and the Asian session; as soon as large banks and institutional investors are finished repositioning their portfolios, they will need to start converting the European assets into dollar-dominated ones again in anticipation of the opening of the U.S. market. The combination of the two reconversions by the big players is the major reason for the extremely high volatility pairs.

For the more risk-tolerant traders, there are plenty o pairs to choose from. EUR/USE, USD/CAD, GBP/USD, and USD/CHF, with an average range of 100 pips, are ideal picks as their high volatilities offer an abundance of opportunity to enter the market. As mentioned earlier, the trade between the

European currencies and the dollar picks up again because the large participants have to reshuffle their portfolios for the opening of the U.S. session.

For the more risk-averse participants the NZD/USD, AUD/USD, EUR/CHF, and AUD/JPY with an average of about 50 pips, are good choices as these pairs provide traders with high interest incomes in additional to potential trade profits. These pairs allow investors to determine their direction of movement based on fundamental economic factors and are less prone to losses due to intraday speculative trades.

U.S.—EUROPEAN OVERLAP: 8A.M.—12P.M. EST

The FX markets tend to be most active when the hours of the world's two largest markets overlap. (see Figure 5.4) The range of trading between 8a.m. and noon EST constitutes on average 70 percent of the total average range of trading for all of the currency pairs during European hours and 80 percent of the total average range of all trading for all of the currency pairs during U.S. trading hours. Just these percentages alone tell day traders that if they are really looking for volatile price action and wide ranges and cannot sit at the screen all day, the time to trade is the U.S. European overlap.

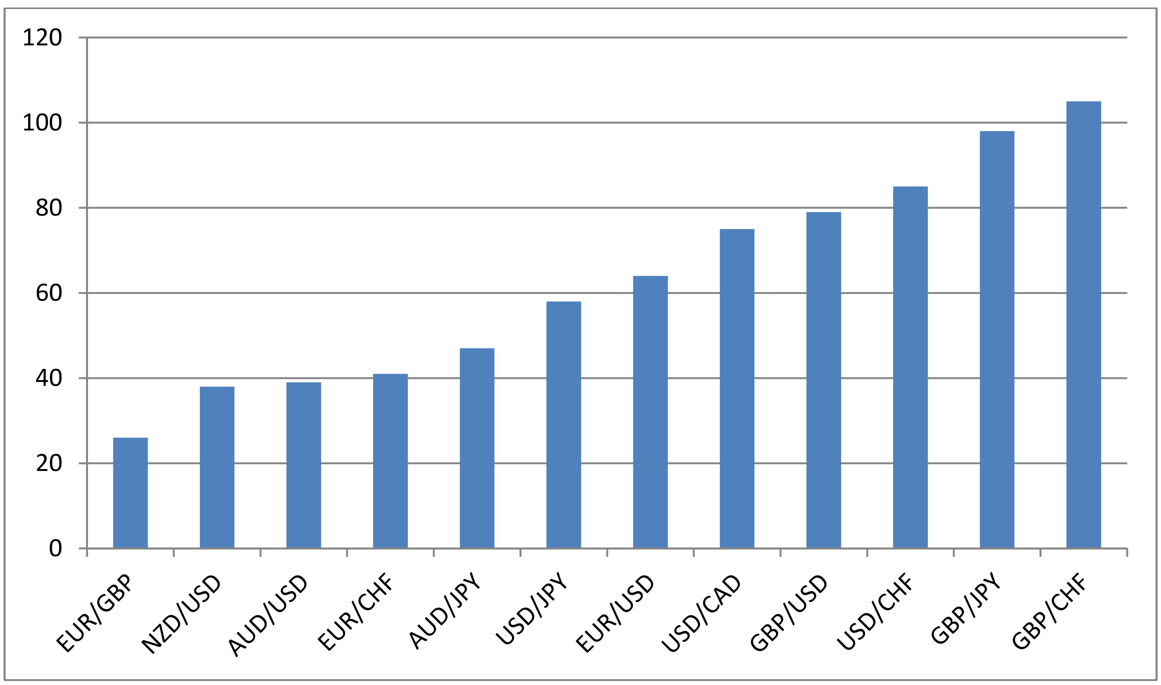


FIGURE 5.4 U.S – EURO OVERLAP

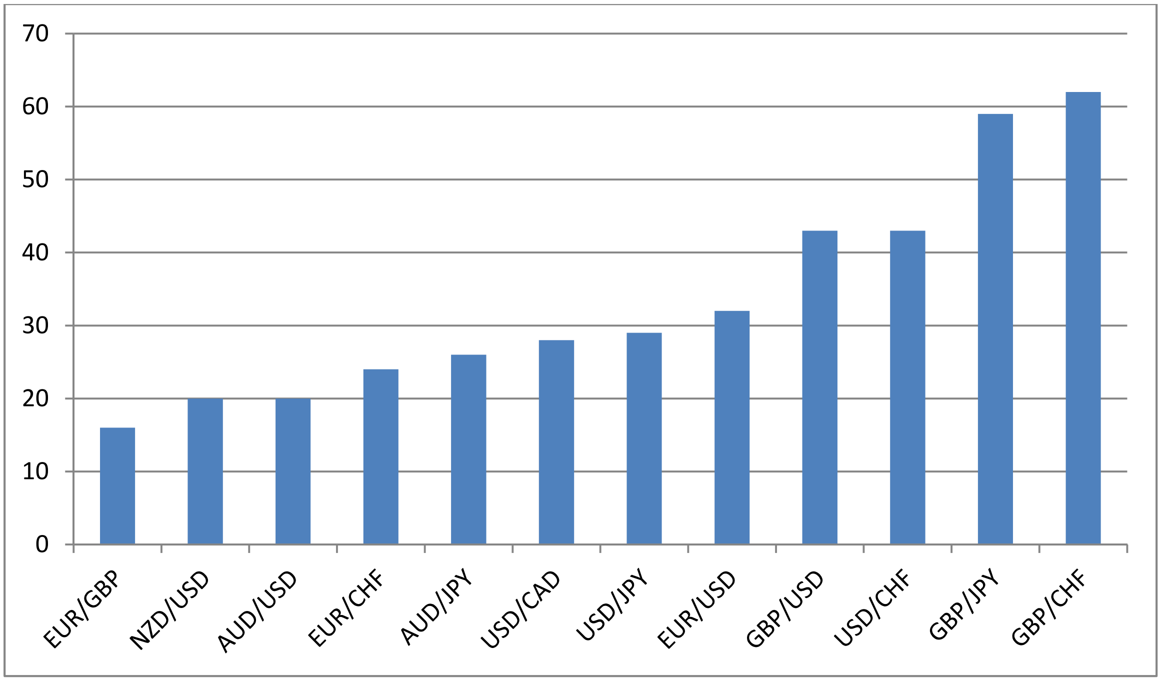


FIGURE 5.5EURO-ASIAN OVERLAP

EUROPEAN-ASIAN OVERLAP 2A.M.-4A.M. EST

The trade intensity in the European-Asian overlap is far lower than in any other session because of the slow trading during the Asian morning. (See Figure 5.5) of course, the time period surveyed is relatively smaller as well. With trading extremely this during these hours, the risk-tolerant and risk-loving traders can take a two-hour nap or spend time positioning themselves for a breakout move a the European or U.S. open.