MIND YOUR MONEY

Caution on the currency-trading scene

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By Reico Wong

CURRENCY trading is regarded as the largest financial market in the world, with rate fluctuations occurring due to changes in political, economic and financial conditions.

It is thus no surprise that the sovereign debt crisis in Europe – coupled with strong fears that it may spread to the United States, Britain and other markets with a high level of exposure to European financial institutions – has caused many Western currencies to fall.

The euro has been hit the hardest. It plunged to a new four-year low to trade at 1.2162 against the US dollar in New York last Tuesday, and slid further to 1.2144 in Tokyo last Wednesday.

The sterling pound has been similarly battered, not only on the back of the troubles in Greece but also by a £163.4-billion (S$332-billion) deficit and uncertainty about recent election results, which have resulted in the first hung Parliament in Britain since 1974.

Last Thursday, the pound fell as far as 1.4231 against the US dollar, its lowest since March last year. It has weakened 4 per cent this year, according to Bloomberg Correlation-Weighted Indexes.

The US dollar, often perceived as a safe haven, has proved to be the strongest of the three currencies thus far.

Asian currencies mostly weakened against the greenback last week, as the market focused mostly on bad news and ignored strong first-quarter output reports from Singapore and Taiwan. Last Friday, the US dollar stood at 1.4078 against the Singapore dollar.

With the steep movements of the euro and pound, investors are increasingly turning to **currency investment** in the hope of cashing in on favourable fluctuations in exchange rates.

But, as markets continue to be highly volatile, caution is advised.

Said Mr Mario Singh, chief executive of FX1 Academy in Singapore: "As much as **forex** is seen as a gateway to financial freedom, it is critical that investors should always protect their capital first.

"To do this effectively, they should not risk more than about 1-3 per cent of their trading capital on any one trade."

Given the dynamic nature of currency trading, investors are strongly advised to first get a solid education on how the forex market works. A good grasp of the various countries' financial background, current standing and the characteristics affecting volatility is also vital.

Additionally, investors should look for a reliable financial institution to conduct their trading, and to provide advice for better judgment calls on currency investments – services that are offered for a fee.

"It's very much also about the extent of volatility the investor can stomach," said Ms Gemma Tay, head of Deposits, Investment and Insurance at UOB (Singapore).

"It's thus important that investors are careful in establishing their **risk appetite** and risk capacity, to determine the suitability of currencies as an investment instrument."

The last two months have seen some of the biggest movements of the forex market in recent history, and this volatility looks set to continue for a while, experts said.

And with the long-term trends of the euro and pound likely to remain uncertain, currency strategists are recommending that investors trade with a shorter timeframe in mind and stay prudent.

"In such situations, I would advise that investors set a short-term target and, more importantly, have a 'stop-loss' target or 'cut-loss' level in place," said Mr Joseph Tan, from the forex department of Phillip Futures.

The 750-billion-euro (S$1.3-trillion) bailout by the European Union (EU) and the International Monetary Fund has given the euro a brief rebound but has generally failed to calm investors, with the common currency of 16 nations continuing its 7 per cent slide to 1.2200 levels last week.

Said Mr Teo Paul Simon of Phillip Futures: "If this financial lifeline cannot assure investors that it can solve the debt problem, it is hard to imagine how the euro can recover anytime soon.

"Having said that, the euro currently looks oversold and there's a possibility of a rebound from short coverings to 1.2600 levels."

"But on a longer-term perspective, it will remain bearish with a possibility of parity against USD by the end of next year."

Mr Singh also said the euro's fall to new four-year lows last week is a clue that it is likely to dip further soon.

Commenting on the sterling pound, Mr Teo said the new British government to emerge will need time to settle down and prove its capability in turning around negative overtones in the market.

Hence, he predicted the fall of the pound to test the 1.3465 level against the US dollar – its lowest since January last year – in the next three to six months.

UOB, in its weekly forex report dated May 10-14, was slightly more optimistic. It said the pound is likely to trade within the 1.4700-1.500 range, and any break above that level will open the way for the currency to hit as high as 1.5250.

Said Mr Teo: "Going forward, the pound is expected to remain low for an extended period, with a possibility of dropping to 1.2500 levels by the middle of next year."

Meanwhile, the US dollar has generally been on an uptrend since last December, as investors shift funds away from riskier assets and markets. Support measures by the EU have also brought about some calm, which has aided the strengthening of the US dollar last week.

But most currency strategists remain cautious. UOB said Asian currencies should still take their cues from external events driven by the euro zone.

This view was shared by Mr Teo. "The near-term outlook for USD looks **bullish** but the upside may be limited to 5 per cent in the next couple of months," he said.

He pointed out that the US economy is still at its bottom, with the government looking to expand exports to close the budget-deficit gap. "It is thus unlikely that a strong dollar would be favoured," he said.

"On the longer term, with the global economy looking at risk of deflation, inflation risk in the US also seems very unlikely in the near term," said Mr Teo.

"Therefore, the US...will probably continue to maintain its low-interest-rate policy and we will not be surprised if, one day, they intervene to weaken the US dollar."

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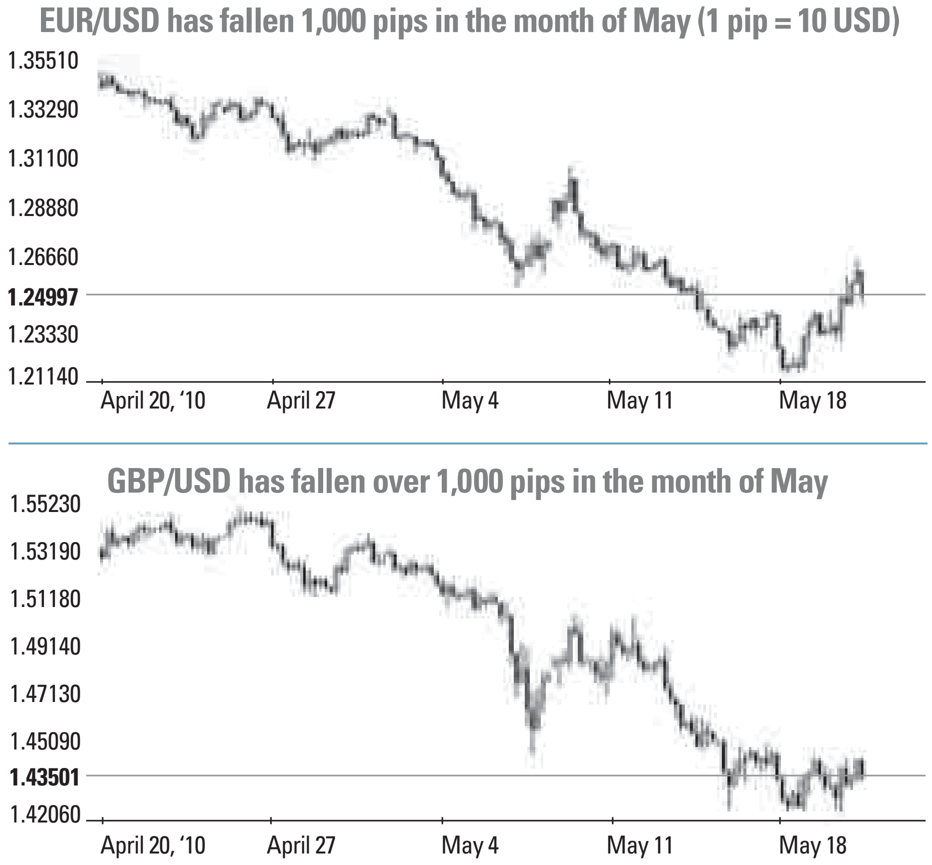
THE FALLING EURO AND POUND



SOURCE: FX1 ACADEMY

HELPDESK 我的字典

Currency investment: 货币投资 huò bì tóu zī

Forex: 外汇 wài huì

Risk appetite: 风险承受度 fēng xiǎn chéng shòu dù

Bullish: 看涨的 kàn zhǎng de