



Theme #7: Trend no bitter end

In 2007 we replicated a RBA study that claimed non-commercial "profit seekers" made money on their IMM positions at the expense of commercial "liquidity seekers".<sup>3</sup> The striking conclusion is that currency speculators generally know the correct direction of G5 currencies and investors can profit from knowing their positions (although these signals are less useful in practice since IMM data is lagged three days).

In a sense, money is "left on the table" by commercial foreign exchange users, and to a lesser extent by foreign bond and equity investors, which can be earned by non-commercial actors that provide liquidity to currency markets. These profit seekers collect FX risk premia in the same manner Keynes first identified when describing risk transfer in commodity markets.<sup>4</sup>

**Profit Seekers Made Money in Every Year since 2003**

By our calculations, non-commercial positions made money in every year since data was first released in 1993, mainly at the expense of commercial users (dealers also made money).<sup>5</sup> In recent years profits have come from timing big EUR/USD moves (2010-11) and catching last year's USD/JPY rise. These P&L numbers more closely resemble pre-crisis profits than the outside gain in 2008 (reflecting higher FX volatility) and the nearly flat 2009 period (probably due to an unexpected GBP rebound).

**IS P&L Eroded As Speculators Accumulate Positions?**

Our analysis rests on the crucial assumption that profit seekers accumulate positions over the course of the week at the average price. By contrast, live trading metrics such as the Parker Index of currency manager returns show a loss since 2011 as currency volatility has overwhelmed macro trends (with the exception of USD/JPY in 2013) even as the correlation between weekly IMM P&L and Parker returns remains positive. It is possible that intra-week volatility causes profit seekers (especially momentum traders) to "buy high and sell low" relative to VWAP and that IMM P&L is eroded when currencies trade in a choppy range. Fortunately for investors FX volatility continues to fall and promising trends (JPY, CAD) have emerged.

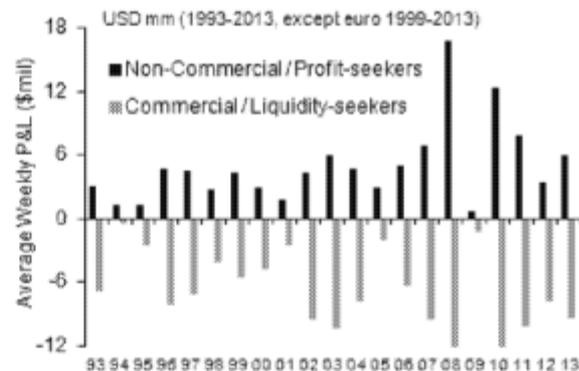
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<sup>3</sup> See Kearns and Manners (2004), "The profitability of Speculators in Currency Futures Markets", Reserve Bank of Australia; and Bilal Hafeez (2007), "Currency Markets: Is Money Left On the Table?"

<sup>4</sup> Keynes, J.M. (1930). "Treatise on Money". London: Macmillan.

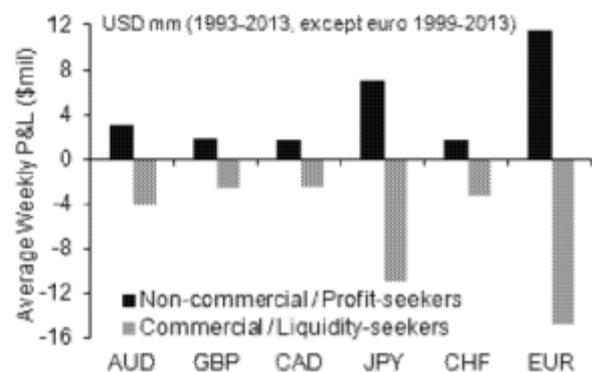
<sup>5</sup> We calculate weekly P&L by determining the notional value of positions on Tuesday and assuming longs and shorts are accumulated (or squared) at the average price over the course of the week.

Figure 1: Absolute P&L (\$mil) of Profit-Seekers and Liquidity-Seekers Using G5 IMM Data (1993-2013)



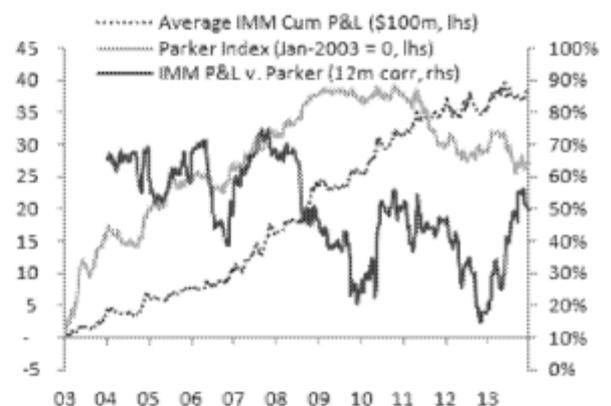
Source: Deutsche Bank, Bloomberg Finance LLP

Figure 2: Speculators had the correct EUR positions in 2010-11 and a large JPY short in 2013



Source: Deutsche Bank, Bloomberg Finance LLP

Figure 3: The Parker Index of currency manager returns has lagged IMM P&L in recent years despite continued positive correlation between them



Source: Deutsche Bank, Bloomberg Finance LLP