

“When the door cracks, will you be ready to move?”



Open Orders and Positions as a Trading Indicator

Professional traders at Forex dealing desks have always had a distinct informational advantage over smaller independent Forex traders. That information gap seems to be narrowing. Dean Popplewell and Scott Boyd crack the door a bit and share how traders can gain access to the open order book and open positions through OANDA's trading platform.

Traders manning the Forex dealing desks of all major investment firms, rely on fundamental and technical analysis to assist in the development of their trading strategies. Fundamental analysis attempts to predict the effect that news events, such as the latest employment results, or the most recent GDP figures, will have on future exchange rates.

Technical analysis uses historical price charts and various decision support tools to evaluate the strength of the rate trend, and to identify potential reversal points.

Historically, professional traders have held a distinct advantage over smaller, independent Forex traders. It has not been uncommon for an investment firm to spend hundreds of thousands on news services to ensure their traders receive news flashes ahead

of the general public. Professional desks also have had access to powerful trading systems with sophisticated technical charting capabilities that were either too costly or simply not available to individual Forex traders.

In recent years, the gap between the trade support available to professional and private traders has narrowed dramatically. Online news services continuously push market news updates to their websites with little or no delay for the general public. Retail trading platforms have also evolved, and rival the most powerful commercial trading systems in terms of charting features and execution quality.

Despite these technological advances, a trader with an investment firm still maintains a considerable advantage over independent traders – the ability to view compiled data on client positions and pending orders for the firm's entire trading base. An investment firm's dealing book displays current short and long positions for each currency pair, and the Forex order book details pending limit orders. Having this information available in real-time, makes it possible to gauge true market sentiment for any currency pair.

If total short positions outweigh total long positions, the firm's clients are obviously "bearish" on that currency pair. On the other hand, if long positions exceed short positions, customers are supporting a rising trend. Being able to confirm market sentiment through empirical evidence, is as close to a guarantee as you can get when trading in any open market.

While a summary of current positions provides insight into current market sentiment, information on pending limit orders provides even more precise feedback. For instance, if the current market price for the EUR/USD currency pair is 1.2855, and there is a large block of sell limit orders just above the market price at 1.2865, you can infer that 1.2865 represents a potential resistance level for the currency pair.

Why can you draw this conclusion? Some of the limit orders could be new entry orders, but it also stands to reason that a large percentage of the pending sell orders around the 1.2865 price point are intended to close existing long positions in a bid to take profits.

Furthermore, if the positions chart shows a high volume of long positions below the market price, this adds further evidence to the likelihood that many of the pending orders at 1.2865 are take-profit orders intended to close existing long positions. Ultimately, it does not really matter whether the limit orders are take-profit orders or new orders to enter into a short position.

The important conclusion is that 1.2865 is a key price level that will trigger selling activity and represents a likely resistance level. Only the dealing desk traders have this information, placing other traders in the market at a disadvantage.

In fairness, this is a rather simplistic example that fails to take into consideration other potential market dynamics. However, it

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does illustrate how positions and orders can be used to gauge overall market sentiment. To use a well-worn expression, this is where the “rubber hits the road.”

For instance, a 30-day moving average superimposed over the market price may indicate that the current price is trending upwards. However, a series of pending sell orders positioned just above the market price is a truer indication of future expectations, and by extension, overall market sentiment. No technical indicator measuring past price performance can provide the same degree of insight into current market psychology.

PUBLISHING OPEN POSITIONS ENSURES TRANSPARENCY AND IMPROVES MARKET EFFICIENCY

Two terms that we hear time and time again in the investment industry, are “transparency” and “market efficiency.” For the casual observer, these may seem to be distinct from one another, but I argue that they are very much related. I would also argue that it should be the goal of all markets – and all market-makers – to facilitate and promote a fully transparent market.

Transparency ensures that all traders are treated the same with equal access to market and pricing information. This ensures that one group is not privy to specific details giving them an advantage over another group. This ensures all market participants can trade in an open and transparent market, which is the very definition of market efficiency.

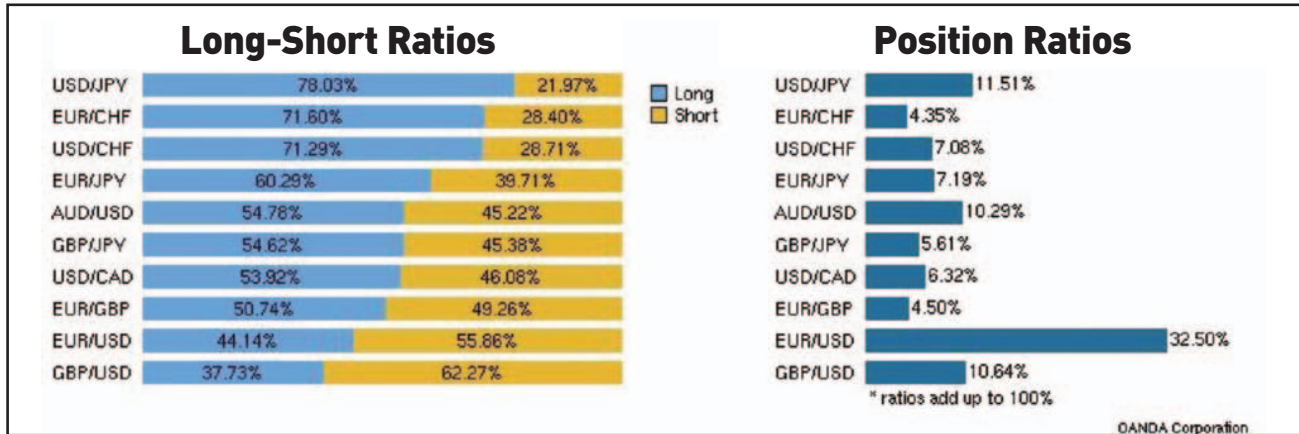
Unfortunately, positions and open order books remain largely the exclusive domain of the dealing desks. OANDA was the first Forex market-maker to break down this barrier when it launched the 'FX Open Positions Ratio' and the 'FX Open Orders and Positions Summary' a few years ago.

These two utilities make up part of OANDA's suite of decision-making software tools, providing a true depth of market view for currency pairs traded in OANDA's Forex market.

OANDA BRINGS AN OPEN ORDERS BOOK TO RETAIL FOREX

The following illustration shows a recent snapshot – in real time – of the positions in OANDA's market. As you can see, long positions dominate the market overall, and several currency pairs in particular are currently held long. Also, in the chart on the

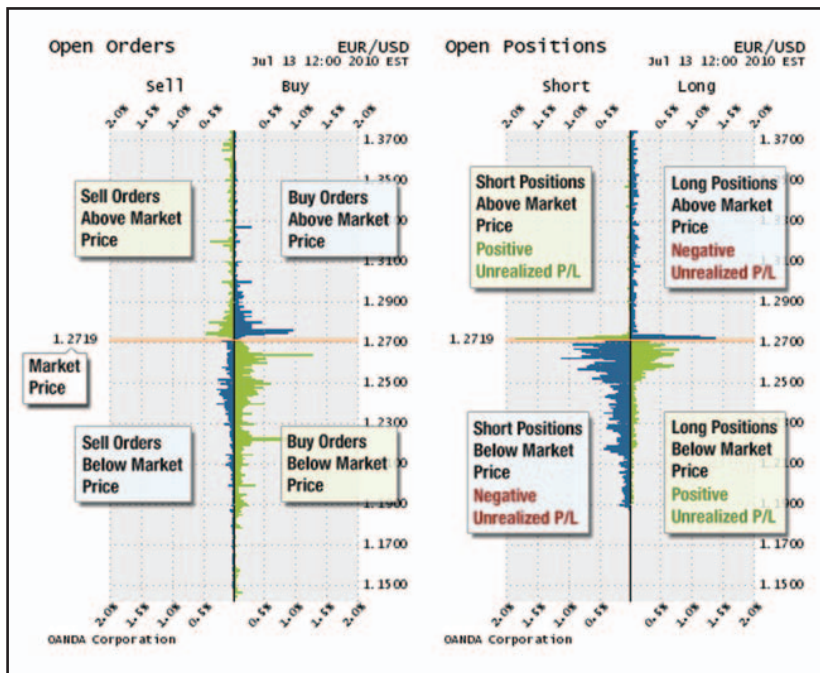
right, you can see that the majority of trades involve, as you might expect, the EUR/USD currency pair:



Knowing the market sentiment with respect to market direction is very helpful in creating a trading strategy. OANDA takes this one step further and publishes complete details regarding open positions, as well as the execution price for these orders:

OPEN POSITIONS

The 'Open Positions' chart on the right side of the previous illustration shows the same level of detail as the Open Orders chart but for actual positions held by OANDA's clients. Plot lines to the left of the vertical center line represent short positions with the placement of the line on the graph indicating the position entry price. The length of the line reveals the percentage of total positions at that entry price for the past twenty-four hours. Note that the positions recorded on the Open Positions chart are still active positions. As such, profit/loss implications are unrealized.



FX OPEN ORDERS

The 'FX Open Orders' chart tracks the pending limit orders held by OANDA's clients. All plot lines to the left of the vertical center line are sell limit orders, while plot lines to the right, show buy orders.

The length of the plot line indicates the number of orders at that price level, expressed as a percentage of the total orders held by OANDA for the past twenty-four hours.

Access to a snapshot of a market-maker's market orders and positions is the ultimate in transparency. By studying the relationship of pending orders to positions, it is possible to deduce potential support and resistance levels for the current market. It is also possible to gain some insight into how traders are thinking and for students of market psychology, this is particularly compelling. **TFJ**

Dean Popplewell has a wealth of Forex experience. He has been a professional currency trader for 10 years, fixed income trader for four years and head of the global trading desks at various financial institutions in Canada. Dean is OANDA's resident currency analyst and has been writing OANDA's daily Forex blog since January 2007 as a way to share some of his Forex experience with the OANDA community. He can be reached at dean@oanda.com.

Scott Boyd is a content writer specializing in the financial sector and has produced educational materials and conducted market analysis for several of Canada's leading financial institutions. Scott contributes articles to the OANDA blog and is keenly interested in the factors affecting global currency prices.