BetterTrader.co

THE ESSENTIAL GUIDE TO TRADING ECONOMIC EVENTS

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INTRODUCTION

Traders pay close attention to financial events by using an economic calendar. But just having the release schedule for economic news events is not enough. BetterTrader can help you anticipate when major movements will occur, then prepare and capitalize on that volatility. In this eBook, we will pass along tips for what professional traders are doing before, during and after news events.

What Is An Economic Event, Or Indicator?

According to wikipedia:

An economic indicator is a statistic that conveys certain information about economic activity. Economic indicators allow investors and traders to analyze the economic performance of a state, country or region, as well as make forecasts about future performance.

For example, each quarter the United States releases data on gross domestic product (GDP). This economic indicator allows investors to analyze the performance of the US economy over the previous three-month period, and make comparisons against the previous year. How fast the US economy grows can have a significant impact on market behavior.

Economic indicators are usually released by governments, international organizations and private research firms.

Understanding Economic Events

Good infrastructure is essential in trading like in anything else, so before we are going to dive into the way we can trade around economic events, let's start with the basics, to make sure that we understand a release and the implications.

Specification of an Economic Event

Currency - The currency of the country that this event is based in.

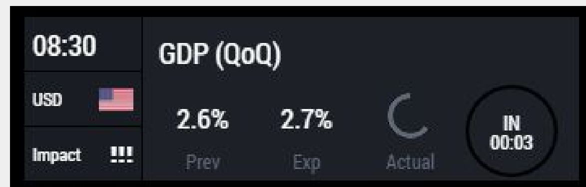
Impact - In the spectrum of low, medium, high, measures how important this event is for traders.

Expectation (EXP) - For almost every economic event there is an expectation. The expectation is the average forecast of the top 50 analysts. This number is very important because this is the reference threshold you can use to judge the Actual release.

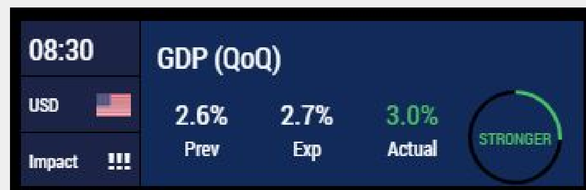
Actual - This is the actual value when the release occurs.

These cards represent the information available before and after the release

Before Release



After Release



Let's say GDP of USA will be released at 8:30 EST. Prior to this moment, all the fields (Currency, Impact, Expectation) are available except the Actual. The actual value will be released at 8:30 EST by the government agency responsible for this measurement.

As traders, we only care about the surprise - the difference between the actual and the expectation. That is what drives the markets, the new piece of data.

Which Markets And Asset Classes Are Most Affected By Economic Events?

Economic events typically have the greatest impact in markets based in the country where the release occurs. This list briefly explains some of the markets impacted by typical events.

1. Currencies (aka FX, FOREX)

Currency pairs, such as EURUSD, are affected directly from events of the two regions, in this case EUROPE and USA.

Example: A positive surprise of the USA GDP (3.0% vs. expectation of 2.3%), will impact that currency pair in such a way that the USD will get stronger over the EUR. This is bearish for the EURUSD forex pair.

The logic behind this: Higher than expected GDP means that the economy is in better shape than estimated. This new information enters the market and increases the probability that the US central bank will raise interest rates. Higher interest rates on a currency will typically push the currency to get stronger.

2. Commodities (OIL, GOLD, Silver, etc.)

Commodities tend to react to macro data such as the Unemployment rate, GDP, and CPI. Additionally, there are events related directly to commodities, such as OIL Inventories.

Example: Crude OIL Inventories releases every Wednesday at 10:30 EST. Of course, the price of oil is impacted by these releases.

The logic behind this: Fewer barrels in the inventories implies that there is more demand for oil than expected.

3. Indices (S&P 500, DAX, CAC40, NIKKEI225)

Economic indicators measure the economic trends and activity at the country level, the stock indices are a reflection of the economic behavior in the country.

Example: If the US Building permits release is stronger than expected, it could push the S&P 500 higher.

The logic behind this: In a healthy market, housing makes up roughly 20% of GDP. The housing market does this in two basic ways: 1) through the physical construction of homes; and 2) through consumer spending on housing services. This impact is in turn felt throughout other industries affecting important metrics such as earnings.

4. Government Bonds:

Government bonds reflect the current interest rate and expectation for changes in the interest rate over time. Many economic events connected to inflation and growth have an impact on bonds.

Example: If the US Unemployment rate is lower than expected (4.4% vs. expectation of 4.6%), this is a positive release for the economy.

The logic behind this: Less unemployment means the economy is in better shape and probably inflation is ahead of us. This may lead the Federal Reserve Open Committee (FOMC) to hike interest rates sooner than expected, which means that the government bonds may drop as well (bond prices go down when interest rates go up).

What about stocks and equities?

Stock indices more correlated to government news releases than specific stocks like Facebook or Amazon are. If you like to trade stocks around economic events, it's better to focus on sectors like trading the building sector stocks after Building Permits, or housing starts.

Why Trade Economic Events?

There are three main factors that combine to make economic events a great time to trade the markets, as long as we are armed with the necessary information and tools for success.

1. Source of Volatility

Economic events cause **expected volatility**. Traders love a volatile market, as it presents an opportunity for significant profits when played correctly. A stable market is boring and hard to profit from. However, **unexpected volatility** can wreak havoc on even the most experienced trader's strategy, which brings us to our second factor.

2. Pre-Scheduled **Expected vs. Unexpected Volatility**

Economic events are **pre-scheduled**. Unlike a tweet from the president, which can send the market into a frenzy with no warning, events like a quarterly earnings report or a Fed meeting are planned far in advance.

Example - Unexpected Volatility

On July 11th at 11:00 A.M. EST, Donald Trump Jr. tweeted out a copy of his email exchange with Russian officials. Although it was a relatively minor event that does not have long-term consequences, the S&P 500 immediately lost more than 0.5%. This is an example of a completely unexpected event affecting the S&P 500.

As you can see, the price returned to its previous level fairly quickly, but this kind of volatility can make life tricky for day traders, especially those who are very active and leveraged.

Where can we get the other kind of volatility - expected volatility? Expected volatility, that we can prepare for, comes from pre-scheduled news (macroeconomic events such as unemployment rate, GDP releases, etc.)

3. Recurrence

Economic events happen on a **recurring basis**. This is crucial because it means that we can measure how the market reacted to each situation, and predict a market move in the case of similar events.

With these three characteristics, we can start to design a system for trading economic events.

Reverse engineer the market logic

With presidential tweets or other unexpected events, we can imagine how we think the market should react, but the market is very unpredictable in these scenarios, and even seemingly good judgment can result in big losses.

When trading scheduled economic events with BetterTrader.co, you can see exactly how the market has reacted to similar events in the past, and statistically analyze how it will move based on the results.

Is Trading Economic Events Dangerous?

There is no debate that economic events cause volatility. At the same time, we as traders need volatility. The only thing that is left to be asked, is if that volatility is dangerous.

Like many other things in life, it is not black and white. The answer is, it depends.

- **If you are not prepared** - Probably the volatility will harm your account, even to buy in the right direction you must execute and manage the trade correctly. Please see this interesting blog post about trade execution.
- **If you are well prepared –** This means studying different scenarios of past releases, and trading only the events with significant market reaction (not the ones considered to be the most important events). Then you could be very successful. You can harness the expected volatility and the recurrence of economic events to your favor.

With the right preparation and methodology, a system of trading rules, and the right tools, economic events are a good opportunity.

Takeaway

Trade only the events with significant market reaction, not the most important events. GDP is an event with a high priority, but it does not mean that the market will react with significance to this event. If that is the case, we as traders should avoid trading it, even though it's considered to be an important event. We need to trade where we have an edge, not just volatility.

HOW TO TRADE ECONOMIC EVENTS

Once we have decided to trade economic events, we need to examine the best way to do so. If the results of an event are stronger than expected, should we take it as a buy? Which asset should we trade for each event? Trading is very complicated today. It's difficult to buy and sell assets based merely on some pattern on the chart. Today, a successful trader must have an edge.

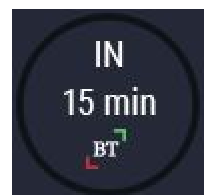
While trading under pressure, it is not enough to rely on memory and emotions. Interpreting and analyzing data in your mind is not a recipe for success in the high-paced world of day trading. We as traders need a system to rely on when there is no time to research and weigh the risks and benefits of every move. It doesn't matter if you use a paper system or a computerized system, you just need a system that works for you.

The system we are presenting here is based on **data collection, analysis, and probabilistic decision making**, eliminating the errors of human logic.

Takeaway

We as traders need a system to rely on when there is no time to research and weigh the risks and benefits of every move. It doesn't matter if you use a paper system or a computerized system, you just need a system that works for you.

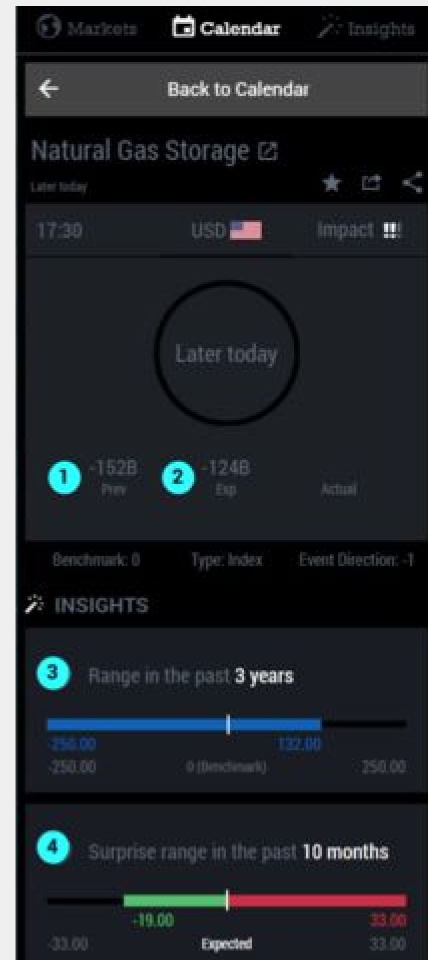
We start our preparation for an economic event 15 minutes before it begins. There are two stages: gathering the basic data and simulation.



Step 1 - Gather The Basic Data

The section describes how we understand the landscape of information for the event we are considering trading.

Gathering the basic data in BetterTrader



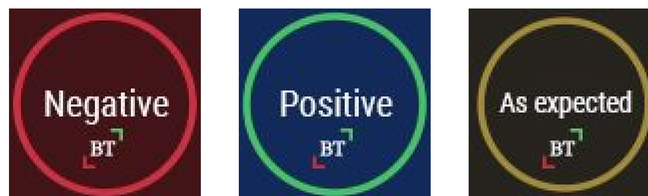
1. **Previous release** - The actual number from the last week or month of that release
2. **Expected results** - Average expectation of the release
   - ❑ **How to use this**: This is the benchmark for the actual release. In general, higher actual than expected is a positive surprise.
3. **Range** of the actual releases over the time.
   - ❑ **How to use this:** As traders we are looking for a break in the pattern. To know the range of releases help us to recognize quickly once the release appears - if that number is out of this range, probably the market will react firmly.
4. **Surprise range** - the range of stronger and weaker releases relative to expectations.
   - ❑ **How to use this:** Using the surprise range from the past 10 months, we can see that a negative surprise is much more likely than a positive surprise. This means that if we see a number that is surprising to the positive side, it's much more sensitive than a number that is surprising to the negative side.

Step 2 – Simulation (or Backtesting)

Now that we understand the landscape, we can prepare to potentially trade the release. We can't be certain about the future, but as a trader, the historical information is all that you have. You can also use your own experience, your own system that uses what you've seen in the past, and what has happened in similar situations.

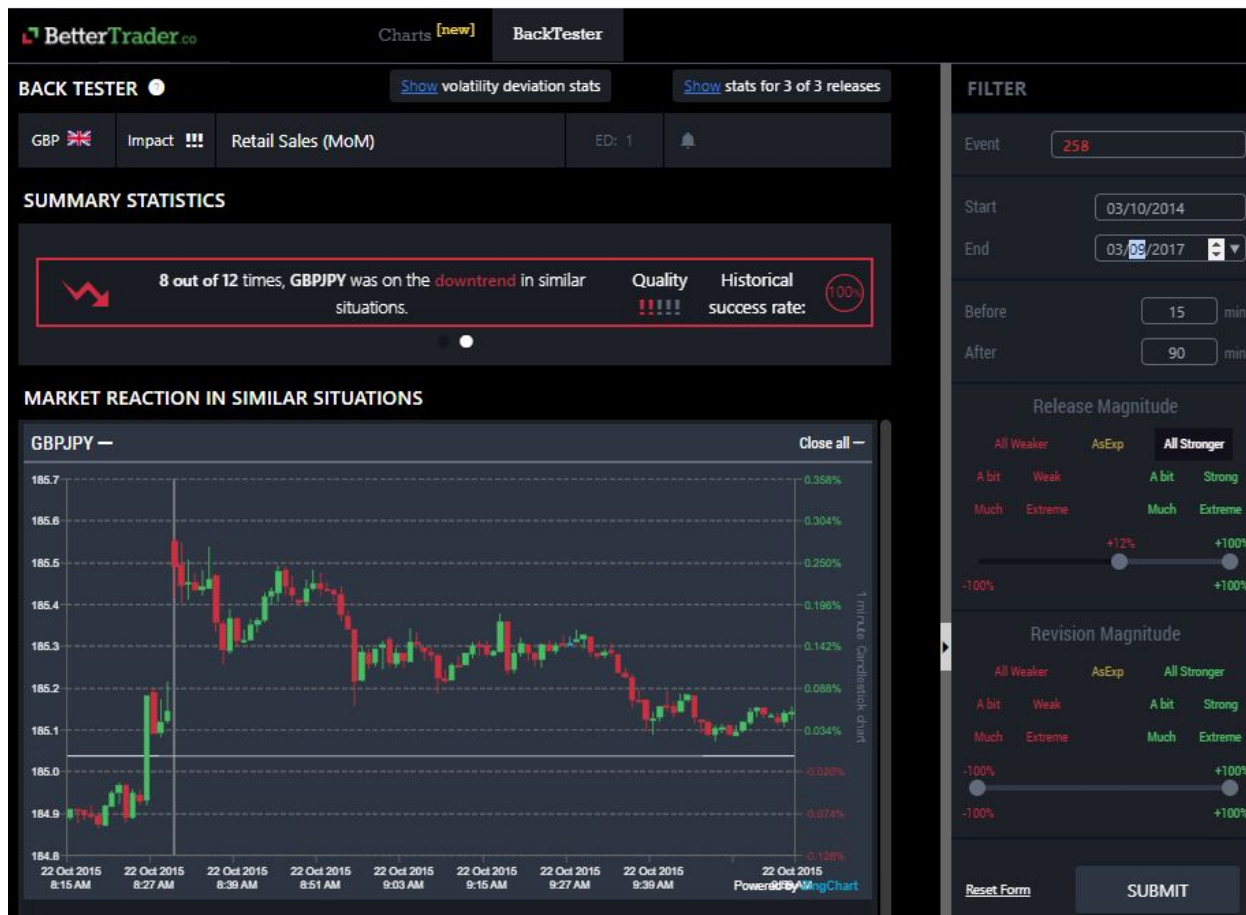
By backtesting *before* the release, we can learn what instrument we should trade *after* the release because we prefer to trade the instrument with the highest correlation with this event.

We can explore the market logic for this specific event using a simulation. We don't know if the results will be negative, positive, or **as expected**, but using the simulation, we can determine what the best trading strategy would be for each of the three possibilities. This allows us to have a clear idea of how to capitalize on each situation, and trade calmly and efficiently rather than panicking after an unexpected result.



Let's use Retail Sales in England as an example. The event is going to be released soon, but we don't know what the release will be. Will it be positive? Negative? We can prepare by simulating the market reaction in pre-set situations. We can simulate a positive or negative release, a bit positive, very surprisingly positive, etc.

Next, we will want to know how other markets will react to the release. Some of the big ones that we look at include currencies, the stock index, OIL, Natural Gas, and GOLD. What you see here is a simulation about the **positive surprise** in relation to **Retail Sales** in the past 3 years. Here is the simulation, 15 minutes before the release until 90 minutes after.



Using the 12 charts given, we can see that among all the data from the last 3 years, out of 36 releases, only 12 were stronger (meaning that retail sales increased significantly). You can see that 8 out of those 12 times the **GBPJPY began a downtrend following stronger Retail sales**. So if this release is positive, we now know what to trade: GBPJPY.

The same approach can be used with negative releases to get some idea about what instruments are correlated and in which direction.

After Release - Real Time Analysis

Once the news is released, you will be in a different situation. The markets start immediately to move faster, become more volatile, and sometimes without logic that we understand at that point. To trade in that situation we must do three things:

1. Understand the new information
2. Analyze that information
3. Plan for the trade

BetterTrader has developed three proprietary tools to support traders in this process:

Proprietary tools to deal with economic events

A. **Surprise Magnitude** - Once an economic event occurs, you can see the magnitude of surprise. Just click the event in the Calendar, and BetterTrader interprets whether the release was stronger or weaker than expected, and by how much.

B. **Perspective Insight** - Descriptive statistics summarize how this actual release compares to past releases.

C. **Statistically Backtested Trade Idea** - BetterTrader uses historical data to see how markets have reacted to similar situations in the past.

Now, when the event occurs, and once you have understood the new information, you already know which market to trade and in which direction. So you are prepared to enter your trade immediately to capture a profit from the expected volatility.

For example, you could already know how much the release is surprising if the GDP expectation is 2.2% and the actual value is 2.8%. If the release is Much Stronger (than the expected value), you already know the best market to trade and are ready to execute the trade. Or if the release is anything less than Much Stronger, you would know that it would be most prudent to skip the trade. Many wise traders have noted that a key to long-term success is to avoid forcing trades that are less than ideal.

To know that this is the highest in the last 4 years and 4 months helps you to get the perspective, and the fact that 5 out of 6 times the S&P 500 moved up following similar releases, supports your idea to buy the index.

What remains is to form a plan for how to trade, also known as executing the trade. In the next chapter, we will present a bit about trade execution.

Takeaway

Many wise traders have noted that a key to long-term success is to avoid forcing trades that are less than ideal.

Where is the opportunity? Which markets offer the best odds?

Now we understand the release and its implications. The numerical difference between actual and expected doesn't mean anything until you have relative terms attached to it, such as 'much stronger' or 'a bit weaker'. With that context and perspective, the release number will mean something, and we might get an actionable trade.

One of the most important things about trading economic events, is to choose the right instrument to trade. Trading the EURUSD after a Weaker US Unemployment Rate might be catastrophic, given the inconsistency of the EURUSD following that kind of event. With the help of BetterTrader, you can see that trading the S&P 500 would be much simpler in terms of volatility, and choosing a reasonable stop loss and profit target.

We also know that in 9 out of 11 similar situations, the S&P 500 was on an uptrend with a negative unemployment rate. That is very useful to know before unemployment is released. This means we can focus on trading the S&P 500 instead of another instrument that has shown less consistent behavior after this release.

Trade Execution

Two traders that get the same decision, let's say BUY EURUSD, could end up with different results. One can end up with a very good profit, and the other can end up reaching his stop loss and losing a significant amount of money. But how? And why? They both took the same trade. Ah, but this moment was just the beginning of the most important part of the game, the execution.

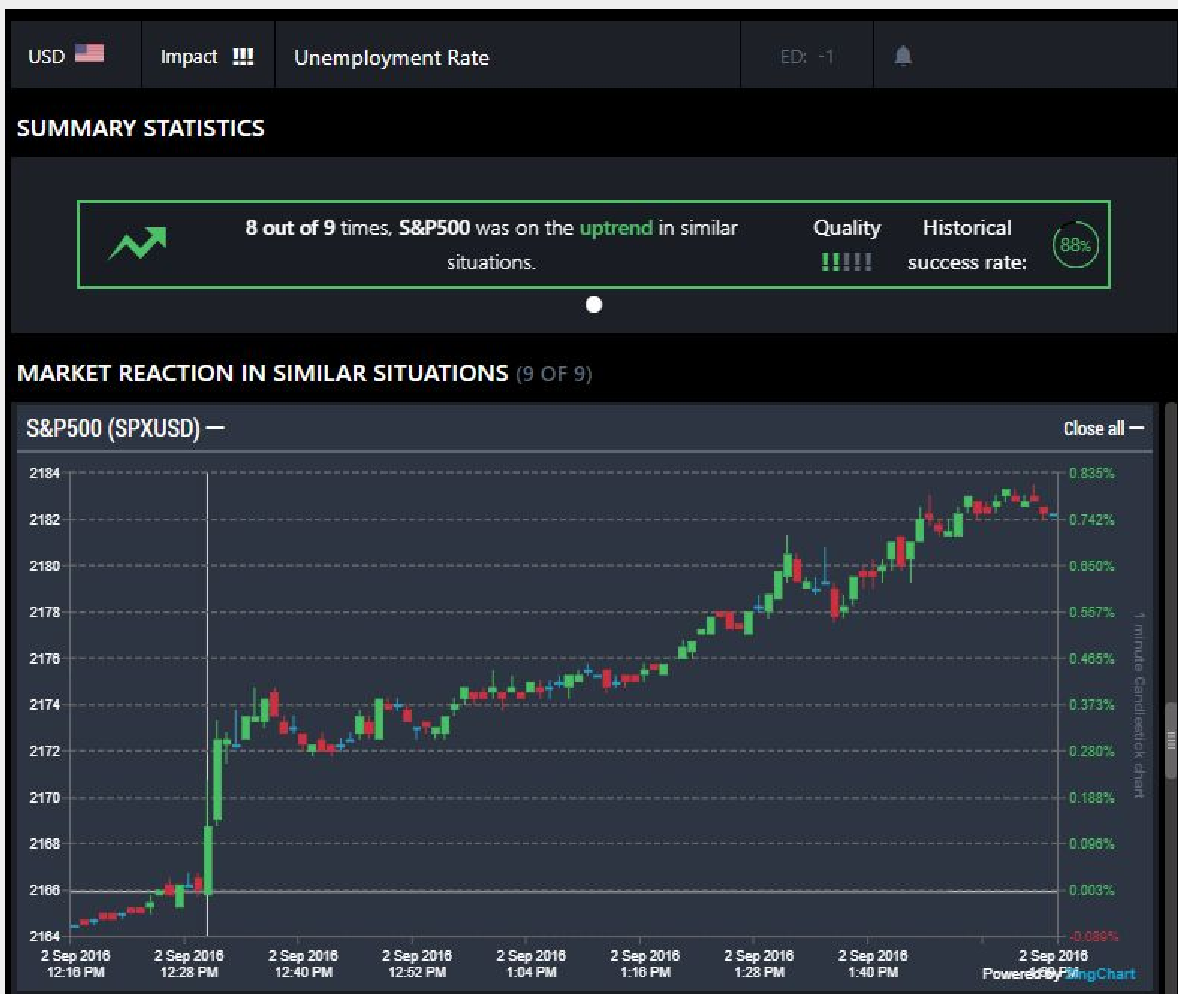
Many traders just buy and then hope, either getting out on the stop, or the profit if they are lucky. That is not enough – that's part of the reason that so many traders lose money.

A question we have to ask is what is a reasonable stop loss for this kind of trade? What is a reasonable profit target? Should we expect 20 ticks or should we expect 100 ticks? 0.25% or 1%? How many times have you seen the market going the right way and then reverse, forcing you to close your trade at break even? With BetterTrader, we can determine what is a reasonable stop loss and what is a reasonable profit target. We can also gauge the expected volatility and trade duration.

S&P 500 and Unemployment rate

Macroeconomic events can greatly impact the market. Whether unemployment increases or decreases, a lot of traders will act on the new information entering the market. This leads to uncertainty.

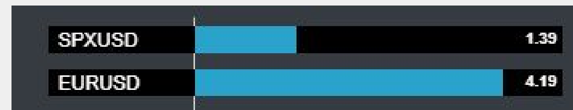
We can use the chart to see how the S&P's volatility will be affected after the release of a new event. In the chart below, after the Unemployment Rate release, we can see that volatility is not high and there is a smooth trend. This means we can set a small stop loss.



Here you could imagine having a small stop loss. In other events and with different instruments you can see that what is a reasonable stop loss for you.

Volatility - S&P 500 vs. EURUSD

S&P 500 volatility after an Unemployment rate release is 1.39 times more than average, and EURUSD is 4.19 times above average.



In this case, many traders would consider EURUSD too volatile to trade. It's important to be prepared so you can make **an informed decision** when the news occurs.

CONCLUSION

Trading economic events can be risky, but with the proper tools and information, it can be very lucrative. As long as you have sufficient preparation, you can tilt the odds in your favor and take advantage of fantastic opportunities.

Not every economic event is a good opportunity to trade, but there are still several good opportunities on a daily basis. During the week there are several events that you definitely want to at least monitor for the opportunity to trade. And if you're looking at macroeconomic events, it's always worth it to be prepared for the release.

Takeaway

If you only take one idea from this ebook it's to prepare before you trade because otherwise, you only have a 50/50 chance of success. The markets today are much more complex than just one positive event causing the market to go up and one negative event bringing it down. We have to be equipped and prepared. You need to develop your own system. Something that will keep up with the market because that's the most important part of trading and will make you more consistent as a trader.

How To Get Started

Running a marathon isn't easy. And neither is trading. It is important to start patiently and carefully. Use these steps as a guide:

1. Follow the most interesting events

Choose significant events that have a high correlation with the market - not only events that inject volatility. Volatility is not enough - even high volatility at a pre-scheduled time is not enough. First we need the event and the specific market to have a strong correlation. Then we need to pick a direction, and determine our stop loss and profit target.

2. Pick 2-3 markets

S&P 500, Oil, and USDCAD each have their own behavior. You cannot master all the markets and you do not need to. Achieving a slight edge in just two or three markets is enough to be a successful trader. I do not say only one market is enough because you would like to develop a skill that holds for a long time, and sometimes markets change, but you want your skills as a trader to stay relevant. If you can trade two or three markets, you can be more successful. The other reason to pick more than one market is that there are correlations between markets - many times one market is a leading indicator for the other. Once you will get the screen time with these markets, you will start to develop your own idea of correlations between them - which will give you more insights.

3. Start Small

After you get a sense for about 5-6 events and 2-3 markets that are correlated, you can start working on a demo account after releases, to get closer to the real experience. Only then should you start jumping into the water carefully after you develop your own personal system, with a strong grasp of the markets and the particular event you are trading. And when you begin, start by trading with a single contract and always be careful not to overuse your margin relative to your account balance.

Get your FREE demo account and economic calendar, all in one place

Three Things To Keep Your Eyes On

1. You don't need to trade any interesting events - try to master a few specific events rather than many events.

2. Monitor the most important events - you do not need to trade them - but you definitely want to see the big picture. Sometimes a shocking unemployment rate release in the morning affects the behavior of the market for the whole day. You shouldn't trade a different event for one hour after the unemployment rate without taking it into account.

Get started with economic calendar - the most important events pre filtered for you (free, no credit card needed).

3. It's about analyzing the statistics to gain an edge - there is no foolproof strategy that will work every time, but by preparing ourselves and making good decisions based on our data, we should win more often than not.

Next Steps

As a trader, you can improve your performance if you:

1. Know how the market reacted in similar situations

2. Get control over your trading

Use BetterTrader's free trial for 30 days to see how our unique software and data analysis can help you.