INTERMARKET CORRELATIONS IN FOREX TRADING

PARAGON
ELITE
TRADING

01

How Gold Affects the Aussie Dollar and the Swiss Franc

However, you need to understand that there is not necessarily a great relationship between the U.S. dollar and gold. The two typically move in opposite directions of one another. The traditional outlook is that when there is economic unrest, investors will dump the U.S. dollar in favor of gold. It has been seen as a safer investment in years gone by.

However, there is a strong correlation between (1) Aussie dollar pairs and gold, and (2) Swiss Franc pairs and gold.

Gold and the Aussie Dollar

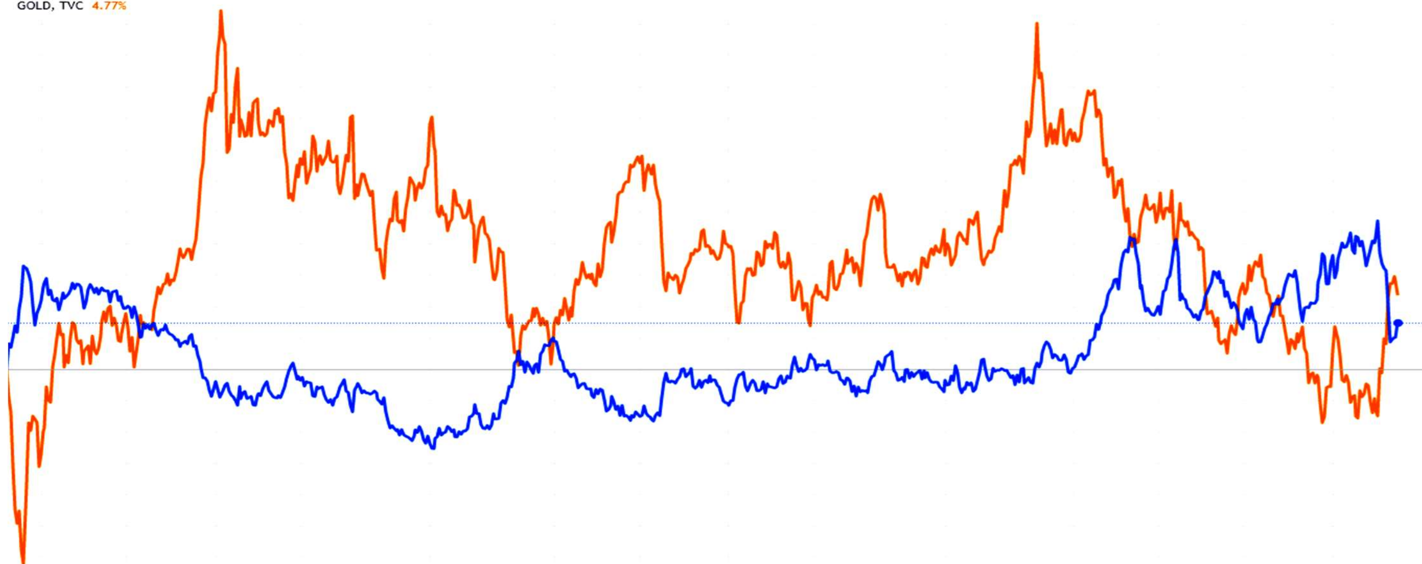
The relationship between gold and the U.S. Dollar still exists, but the dynamics of that relationship have changed to some extent. The dollar has a safe-haven appeal to it these days, and that means that the dollar is likely to increase in value even during economically unstable moments. During times of economic growth, the opposite tends to happen.

The opposite is true for the Aussie dollar, which has a strong positive correlation with the gold market.

Gold and the Swiss Franc

The Swiss Franc is also positively correlated with gold. That means that since CHF is the **quote currency** in the USDCHF pair, typically, the USDCHF tends to fall when gold rises and vice versa. ***Thus, USDCHF is negatively correlated with gold prices.*** Why? More than 25% of Switzerland's money is backed up by gold. This means that Switzerland needs to import much more gold than many other countries do. They don't produce it as Australia does, but their economy is propped up on gold.

Take a look at this chart (**USDCHF in blue** and **Gold in orange**):



Traders can observe what they see in the currency markets to make moves in the commodities markets and vice-versa.

02

How the Price of Oil Moves with the Canadian Dollar (and USDCAD)

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Foreign currency traders always need to think about how a variety of markets can impact the trades that they make in currencies. As it turns out, one of the other types of markets that traders should look at includes the oil markets. How do they trade against the USDCAD pair?

Oil is completely necessary for our modern economy. Canada happens to be one of the world's largest exporters of oil in the world. They exported more than 4 million barrels to the United States alone every day in 2021. This makes Canada the main supplier of oil to the **United States** out of any other country in the world. Canada's

Rank	Country	U.S. Oil Imports (2021, in barrels)	Share
#1	Canada	1,584 million	51.3%
#2	Mexico	259 million	8.4%
#3	Russia	254 million	7.9%
#4	Saudi Arabia	156 million	5.1%
#5	Colombia	74 million	2.4%
#6	Ecuador	61 million	2.0%
#7	Iraq	57 million	1.9%
#8	Brazil	52 million	1.7%
#9	South Korea	48 million	1.6%
#10	Netherlands	46 million	1.5%
#11	Nigeria	45 million	1.5%
	Other countries	459 million	14.7%
	Total	**3,091 million**	**100.0%**

Canada's economy is heavily dependent on exports of oil, but it also creates a lot of demand for Canadian dollars to buy all of the oil that they need out of Canada.

If the U.S. economy is humming along and demand is increasing, then more oil may need to be imported into the country. That could lead to a fall in the USDCAD pair, as more money goes into buying Canadian dollars to purchase more oil.

If the U.S. economy is faltering, then oil demand may decrease, and the USDCAD may find itself soaring.

Oil had a negative correlation with the USDCAD pair for about 93% of the time between 2000 and 2016.

03

How the Relationship Between the U.S. Dollar and Oil is Changing

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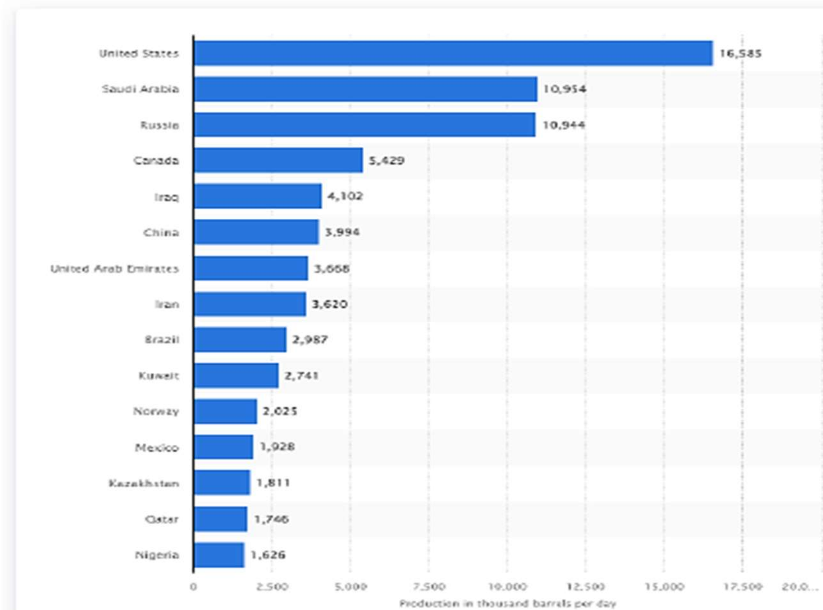
There is a history between the U.S. Dollar and the price of oil. In the past, they used to have an inverse relationship. That is to say, as oil went higher, the U.S. Dollar would fall and vice versa. **This was because of two main reasons:**

- The price of a barrel of oil is priced in U.S. Dollars. When the dollar is strong, you need fewer dollars to purchase oil. When it is weaker you need more.
- In the past, the United States was a net importer of oil.

The first point still holds to this day, but the second one is no longer the case. Fracking technology and other advancements in the industry have allowed the United States to increase its energy independence over the years.

Interestingly, in 2011, the United States became a net exporter of petroleum products. The United States even overtook both Saudi Arabia and Russia in our production of crude oil! Check out the chart below of the top oil-producing countries in 2021:



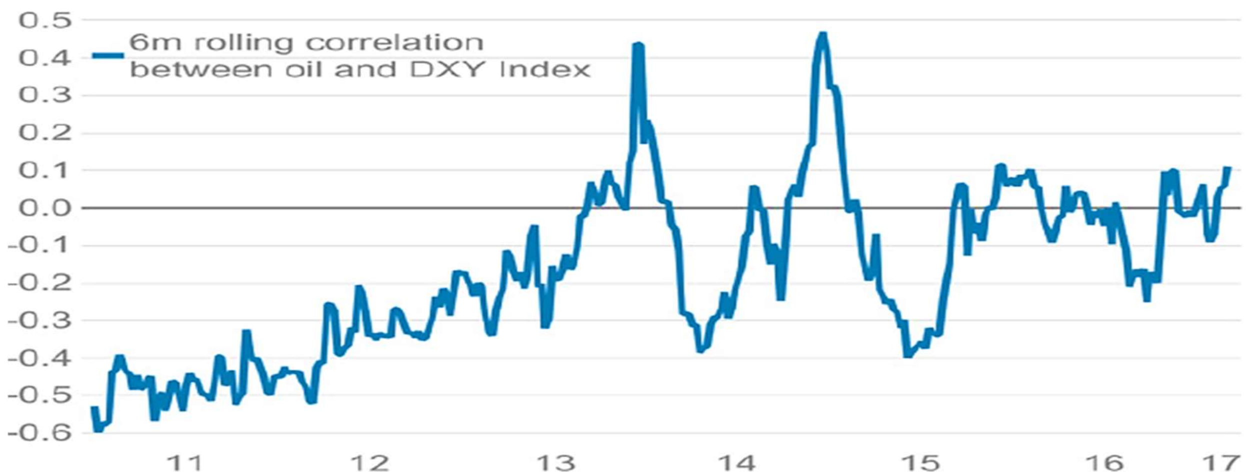
The breakthrough of fracking has disrupted oil markets and has made it interesting to see the changes in the relationship between the U.S. Dollar and oil prices.

Higher oil prices are a net benefit to the U.S. trade deficit these days as the country is now a net exporter of petroleum products.

It is no longer the case that high oil prices are a pinch on the budget in the United States like they once were.

The historically inverse relationship between the U.S. Dollar and crude oil prices is now not so locked in. Check out this overlay of the U.S. Dollar Index (DXY) and oil prices:

This has been pronounced, as you can see in this chart of the six-month rolling correlation coefficient between the DXY and oil prices — which has moved from net negative correlation to a much more unstable correlation.



It wouldn't be shocking to see the relationship between the two completely change in the future. Some anticipate that the inverse relationship may completely flip. There may be a direct correlation between the U.S. Dollar and oil prices in the future. The U.S. now has a significant influence over the price of oil globally. Given the rising production levels in the United States, it is now in a stronger position than it used to be as far as the oil markets are concerned.

Traders should position themselves in a way where they aren't relying on the historically inverse relationship between oil and the U.S. Dollar. That is just the old way of looking at things, and it is not nearly as valid as it once was.

04

How Bond Yields Affect Currency Fluctuations in Forex

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Every financial market in existence has some impact on every other market. The mere movement of money around the various markets either allows for more investment in a particular market or keep money out of those markets. Either way, they matter, and the same is true for the bond market. A bond is an "**IOU**" issued by an entity that needs to raise money for some purpose or another. **Investors buy those bonds on the promise of being paid back at a later date, with interest.**

Bonds are paid back to investors on a set schedule and for a set interest rate.

The **bond yield** refers to the percentage that the bondholder is paid for their investment. The bond price is the amount that the bondholder paid to own the bond in the first place. Both figures are important to understand because they both contribute to the true value of that bond in the long run. **Bond prices and bond yields are inversely correlated. When bond prices rise, bond yields fall and vice-versa. Here is a simple graph to make it easier to picture:**

Another way to look at it is like a seesaw:

The way that you can use this information for currency trading is by paying attention to the bond yields offered by the bonds of any given country. Believe it or not, the bond yields offered by the bonds of a specific country are very likely to indicate the strength of that country's economy and its stock market. Thus, it is important to pay attention to the bond yields offered by a country's bonds to try to figure out where that country's stock market might be headed.

Essentially, government bond yields act as a guide to the general direction of the country's interest rates and expectations.

The 10-year Treasury note is a key measure of the US dollar's strength. When its yield rises, it signals bullishness for the dollar. Conversely, when its yield falls, it indicates bearishness for the dollar.

Therefore, it's important to understand why the bond's yield is increasing or decreasing. This could be due to changing interest rate expectations or it could be the result of investors shifting their money from riskier investments such as stocks into safer ones like bonds. This is known as a "flight to safety" and can have an impact on the yield of the 10-year Treasury note. Understanding these underlying dynamics helps investors prepare for changes in the US dollar.

Also, demand for bonds tends to increase when investors are worried about the state of the stock market in their domestic markets. Thus, a rising interest in the purchase of bonds in a specific country may indicate that the country's stock market is not likely to do well in the near future. In that event, it might be wise to consider making some plays against the currency of that country.

In other words, it might be wise to short the native currency of a country that is experiencing rising interest in purchasing bonds.

Remember, when using this as a potential strategy, always try to pair a strong currency against a weak one. In other words, if you want to short the US Dollar, try to find the strongest currency that you can pair it up against to buy the strong currency and short the dollar. That is one of the best ways to capitalize on the information that you have obtained from the bond markets.

05

How Exchange Rates are Affected by Bond Spreads Between 2 Countries

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The exchange rate between different currencies can be influenced by several factors. One of those factors is the bond spread between the two countries, which is the difference in the countries' interest rates. Let's take a look at how this happens.

If you monitor the bond spreads between various countries, you might get some clues about where their currency pair is headed.

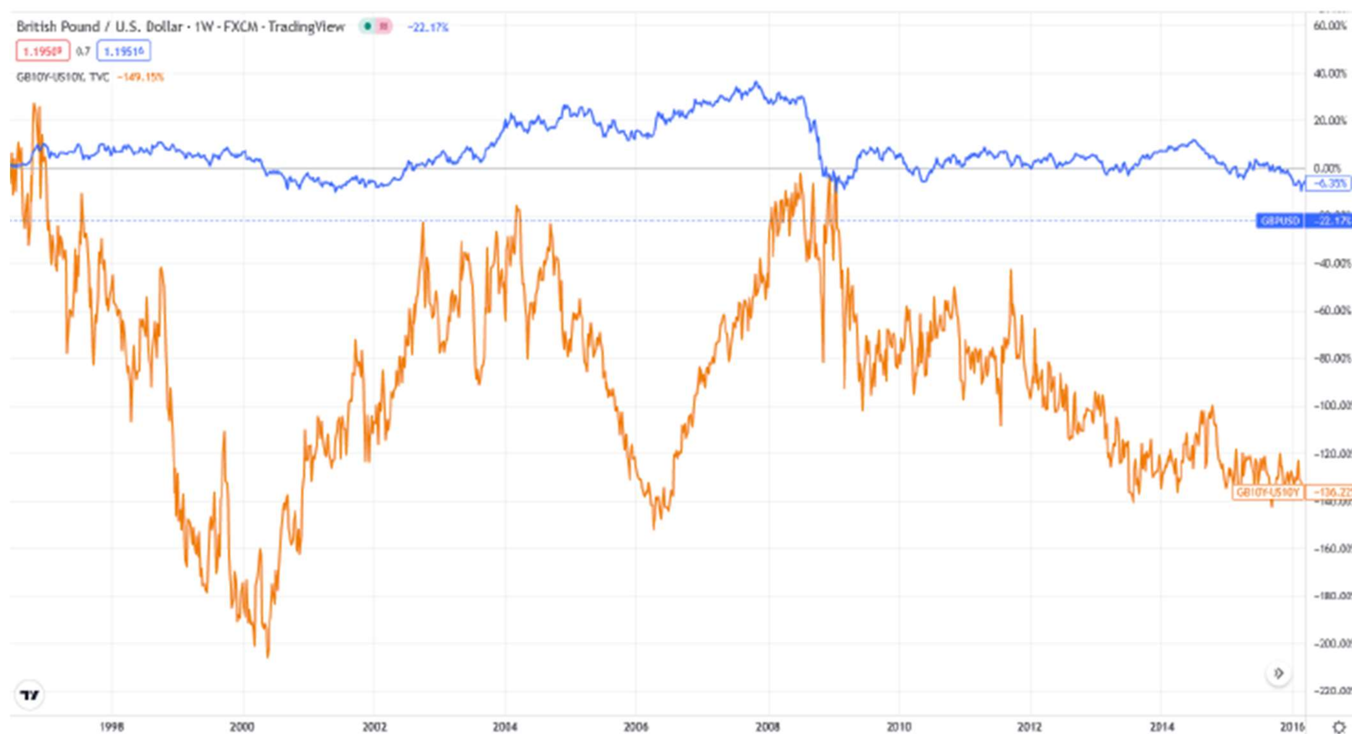
Here is an example:

When the bond spread widens, the currency with the bonds paying a higher interest rate is likely to appreciate. The currency with the lower rates may fall in value. Thus, you might be able to predict where certain currency pairs are likely to trade based on this information.

You can see this play out between the Australian Dollar and the U.S. Dollar. The bond spread between the two rose from -50% to -5% between 2002 and 2004. During that same time period, the Australian Dollar increased almost 50% against the dollar, from 0.5000 to about 0.7000. It happened again in 2007, when the spread went from -60% to +55% and the value of the AUD climbed by almost 2,000 pips against the USD.

However, the AUDUSD reversed course with the recession of 2008, as traders started to take advantage of the carried trade and wanted to cash in on the wide difference in interest rates offered between the AUD and USD.

To see one more example of how exchange rates are affected by bond spreads, check out this chart:



In general, you can see that when the bond spread between the UK bond and the US bond drives lower, the GBPUSD weakens also. When the bond spread drives higher, usually the GBPUSD price does also.

06

Do Fixed Income Securities Affect Currency Movements in Forex?

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The spread between interest rates for the bonds of two different countries can be an indicator of where the currencies of those countries is likely to go. **When the bond spread widens, the currency with the bonds paying a higher interest rate is likely to appreciate. The currency with the lower rate may fall in value.**

Fixed-income securities (such as bonds) are an investment type for conservative investors who want to be paid a fixed payment on a specific timeline.

In theory, economies that offer higher interest rates on their fixed-income securities should attract more investment into those securities. After all, who doesn't love the idea of being paid a higher rate of return than what they would typically receive from another country?

Let's take an example of how this might play out. Imagine that the **United Kingdom** is offering a 2.5% interest rate on 5-year bonds. Meanwhile, the **United States** is only offering a 1.5% rate for the same timeframe on its bonds. In that case, investors would be attracted to the higher rate offered in the United Kingdom. That could push the GBPUSD higher as the pound makes up ground on the dollar. Investors see the economy of the UK as stronger than the United States at that moment, and they are ready to pounce on the opportunity.

Those who want to use fixed-rate securities as a potential data point for their currency trading can review the data that is available about these interest rates at a few different financial publications. Chief among them are:

- **Bloomberg**
- **Trading Economics**

These are generally pretty accurate readings of what one can get paid for certain fixed-income securities. On top of that, they can provide information to you about how the fixed-rate securities of a wide variety of countries are performing. That might be extremely useful information for you to put to use in your trading strategy immediately. Don't overlook something like this when gathering information. You will want to collect every indicator that you can to provide a full picture of what is happening in the **Forex market**.

Nations' bonds even have cool nicknames! Here are a few for your reference:

ECONOMY	BONDS OFFERED
United States	U.S. Treasury bonds, Yankee bonds
United Kingdom	Gilts, Bulldog bonds
Japan	Japanese bonds, Samurai bonds
Eurozone	Eurozone bonds, Euribors
Germany	Bunds
Switzerland	Swiss bonds
Canada	Canadian Bonds
Australia	Australian Bonds, kangaroo bonds, Matilda bonds
New Zealand	New Zealand bonds, Kiwi bonds
Spain	Matador bonds

07

How the Forex and Global Equity Markets are Interrelated

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It is possible to use global equity markets to try to determine the next moves in the Forex market. Some people even look at equity markets as a foreshadowing of what might play out in the Forex market.

The stock or equity market is what is most likely covered in the media in your area. To purchase stocks in a particular country, you first need to hold the currency of that country in your hands. Therefore, when people start to hear a lot of chatter about the stocks of a particular country, they may get very excited about investing in that country. If that is the case, then they might need to purchase some of the currency in that country. That could drive the price even higher. The exact opposite happens when the stock market of a particular country begins to look less appealing.

It is also important to pay attention to how the stock market in one country is behaving in relation to another. If one stock market appears to be outperforming that of another, then the money may flow away from the currency of one market and into the country with the better-performing market.

It is easy for some Forex traders to skip past the equity markets and think that they don't relate to what they do. Understandably, some people feel that way. However, it is just not the case. The truth is that Forex markets and equity markets are often closely connected, and people who operate in either should pay attention to both. There is simply no excuse for not paying attention to what each market is doing. They tend to provide information about one another based on their movements. At the very least, you want to know what is happening in each type of market so you aren't caught flat-footed when it comes to your trading choices. You need as much information as you possibly can gather to make your trades as informed as possible.

Those who trade in the Forex market should pay attention to the equity markets even if they don't personally trade stocks. You might discover that there are a lot of lessons that you can learn from these markets even if you don't necessarily actively trade in them yourself. You should pay attention because you don't want to miss out on the opportunity to learn some lessons from the equity market about how the values of different currencies may rise or fall.

The performance of different stock markets against one another lead to potential opportunities to make money for yourself if you follow those trades closely. This is to say that you need to pay attention to what is happening in the markets because you might be able to spot the difference between the performance of different stock markets and see how this corresponds with the way that the currency for that country operates. If you notice the pattern is strong enough, then you might want to try to pick up on this and place some trades in the Forex markets based on what you see in the equity markets.

Keep in mind that it is all about relative strength. Just because the U.S. stock market is having a down day does not mean that the dollar will fall. Foreign stock markets may have an even worse day than the US market. If that is the case, then you might be able to profit by placing your trades just right in the Forex market. You can still potentially earn profits by purchasing the U.S. Dollar in this scenario. It just might be the case that the USD still rises in relation to other currencies depending on how those foreign markets are doing.

08

How the Forex and Global Equity Markets are Interrelated

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People have always asked, which leads the other: **Forex** or **stocks**? It’s just not that easy to tell which dance partner is leading or which is following.

The general belief is that when the economy of a country is strong, its equities market is also strong, and its currency will be as well. Thus, one might think that if stocks in a particular country are rising, then it is reasonable to expect that the currency in that country will also rise. Foreign investors will pour their money into those markets and increase the demand for that country’s currency.

It all sounds so easy in theory, but the reality of the situation is often more complex.

For an easy example… The relationship between the U.S. Dollar and the S&P 500 has not been historically correlated. In many instances in the last twenty years, the two have moved together, moved opposite of one another, and have had no real correlation at all.

This shouldn’t lead you to think that there is no relationship between the two at all. It simply means that you need to know when the connection between the two is strong and when it is not.

If there is upbeat economic news in the **United States** and another country at the same time, then the impact on the U.S. Dollar might be net negative, but the U.S. **stock markets** might rise.

Check out the correlation between the Dow (blue) and the Nikkei (orange):

Interestingly, the correlation between stock markets might be a stronger connection than between markets and their respective currencies. The Dow Jones and Nikkei exchange have moved in tandem with one another for roughly the last twenty years. They have carried very similar paths over that time, which tends to happen in most nations' **equities** markets.

09

A Case Study on How the Stock

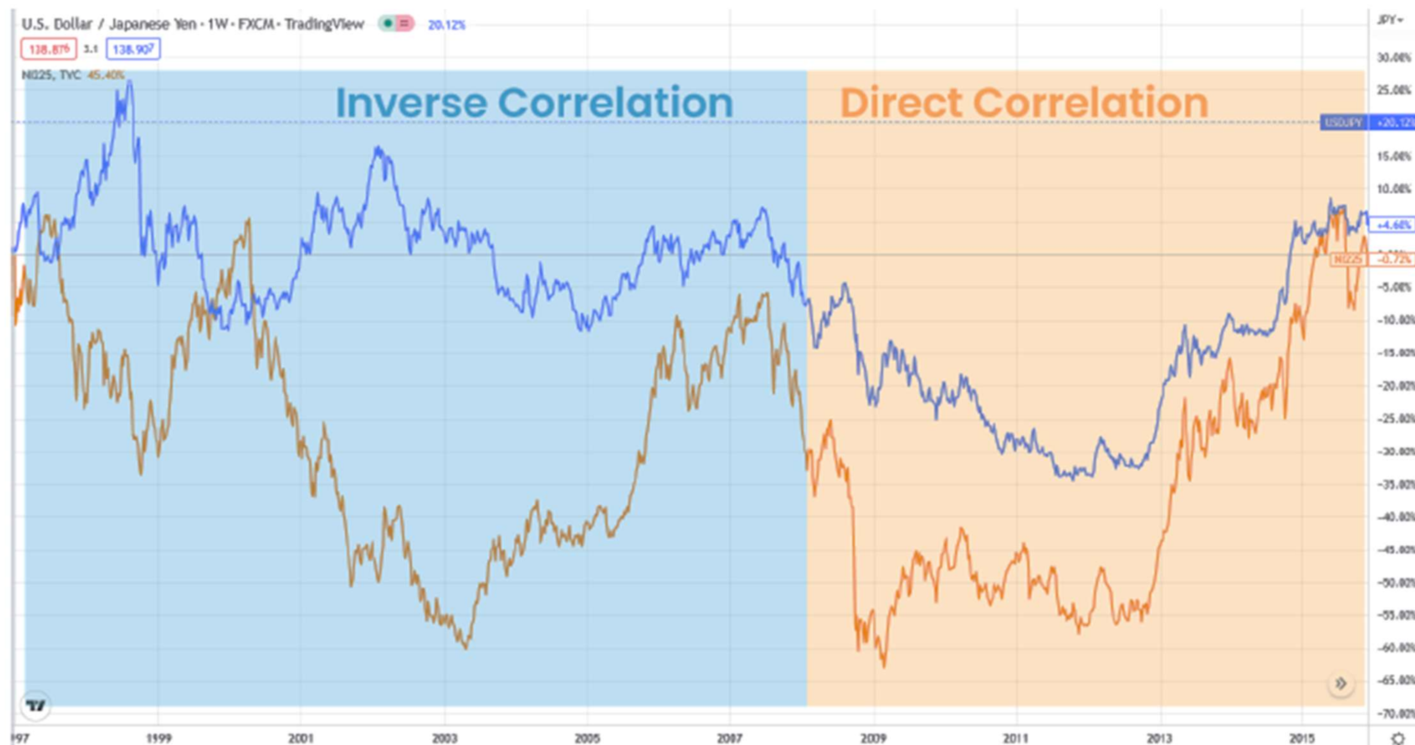
Most people use the performance of a particular stock index to talk about the performance of the stock market as a whole. Those indices are set up as shorthand for how the overall market is doing, so it makes sense that people refer to them in that way.

In today's lesson, we will look at how the Forex market has a direct impact on two specific indices.

- **The Nikkei 225** (aka the Nikkei) – This is Japan's main index. It measures the performance of the 225 largest companies in Japan.
- **The Dow Jones Industrial Average** (aka the Dow Jones) – This is the performance of 30 large American companies presented in an index.

Nikkei and USDJPY

Before 2007, the Nikkei and the USDJPY were inversely correlated. When one went up, the other went down. That was all before a global recession in 2008 and 2009 that roiled the world and changed almost everything, but at the time it was true.

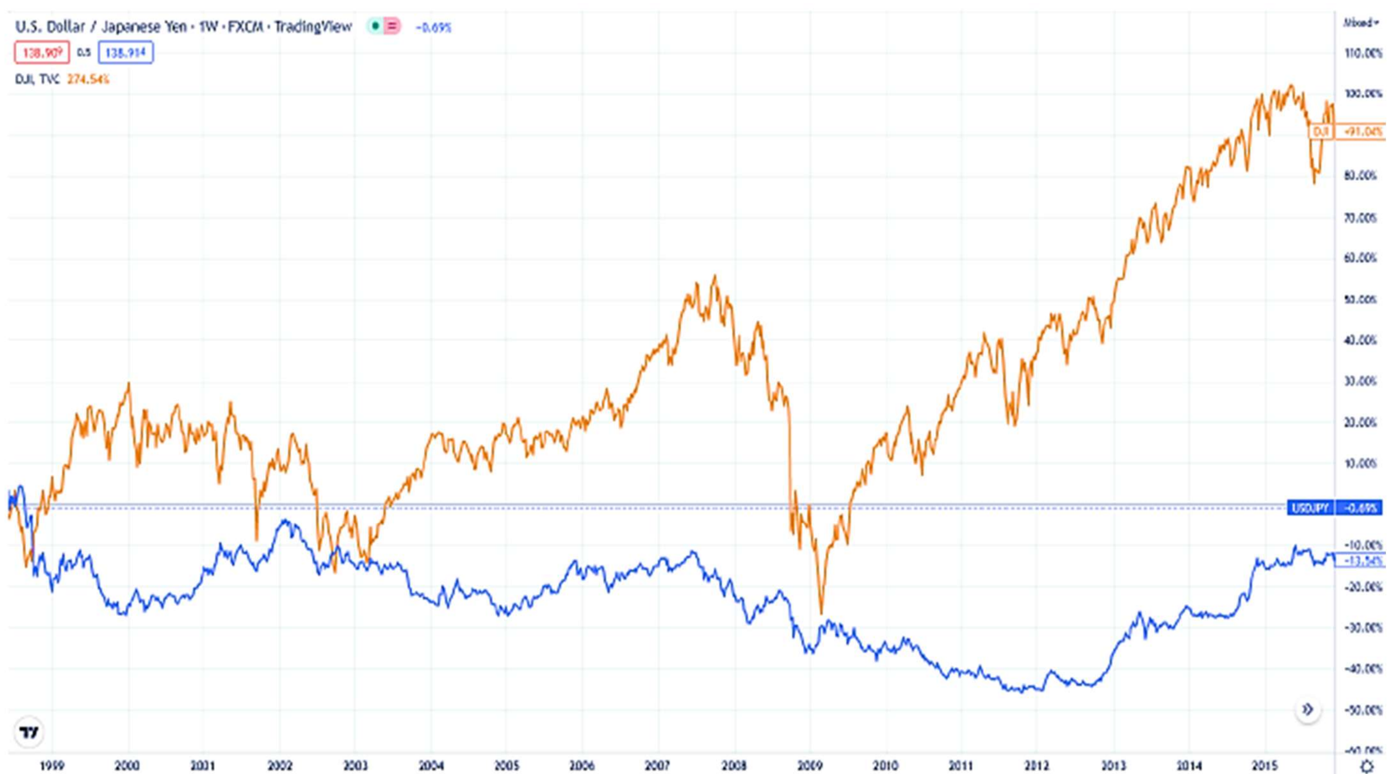


After the recession, the Nikkei and USDJPY started to move in tandem with one another. It now seems that stocks in Japan and the performance of the USDJPY are very closely related to one another.

Correlation Between USDJPY and the Dow

A rising dollar is not necessarily great news for the Dow Jones stock exchange. It is made up of the largest companies in the country, and those companies often rely on international sales. Thus, a higher dollar means they generate fewer profits on their international sales. As such, a falling Dow Jones index might actually be good news for the USDJPY pair.

However, the correlation is not quite as strong as you might imagine. Just check out the chart below, with USDJPY in blue and the Dow in orange.



The Dow Jones stood at 14,000 in late 2007 before falling hard in 2008. **The USDJPY also fell during that time, but not as much as the Dow Jones.**

Thus, it is important to always remember fundamentals when looking at the movement of various currencies and comparing them to the movements of stock indices. Sometimes, there are larger forces at play than you may realize, which is important to remember we are looking at how different asset classes relate to one another. It might not always be as smooth or crystal-clear as we might want to believe. And while that fact may be frustrating, let's assume it weren't true and that certain correlations between certain assets were consistently really high or low. Large gains are hard to achieve when the entire market already agreed / agrees with us.

09

A Case Study on How the Stock Market Affects the Forex Market

When it comes to predicting **stock market** direction, one of the most useful leading indicators is EURJPY. This **currency pair** has a strong correlation with global equity markets and can provide valuable insight into where **stocks** may be headed in the future.

You should know that the yen, along with the USD and CHF, is considered to be a safe haven amongst the major currencies. This means that when global equity markets are in turmoil, investors often flock to these currencies (and away from stock markets like the DAX and S&P 500) as a way to protect their investments.

One of the main reasons that EURJPY is such a reliable indicator for stocks is because of its strong correlation with global economic growth. **When the economy is doing well and investors are feeling more optimistic, the EURJPY pair tends to go up. Conversely, when the economy is struggling and market sentiment is bearish, then this currency pair will tend to go down.**

The best way to use EURJPY as a leading indicator for stocks is to look at the chart and watch for key breakouts. When the EURJPY pair breaks out above a certain level, it can signal that there may be an impending move higher in stock prices. Conversely, if the EURJPY pair breaks down below a certain level, it can signal that there may be an impending move lower in stock prices.

In addition to watching for breakouts, traders can also look at the direction of the trend. When EURJPY is trending higher, it generally indicates bullish sentiment in the market and could signal that stocks are likely to go up. Conversely, when EURJPY is trending lower, it usually indicates bearish sentiment in the market and could signal that stocks are likely to go down.

Using EURJPY as a leading indicator for stocks can be an effective way to identify potential trading opportunities. In addition, traders can also use this currency pair to confirm other technical indicators such as **trend lines** and **moving averages**. By combining multiple indicators, traders can gain a better understanding of the overall market trend and make more informed trading decisions.

You can see these correlations in action. Check out the below charts of:

- S&P 500 vs. EURJPY
- DAX vs. EURJPY

S&P 500 in orange / EURJPY in blue

DAX in orange / EURJPY in blue

ABOUT PARAGON ELITE TRADING

Here at Paragon Elite, we aim to tackle the key reasons that cause most solo traders to fail:

1. Lack of knowledge and proper training, which includes interactive coaching to help a trader formulate a trading plan that plays to that trader's individual strengths.

2. Lack of meaningful levels of capital to trade. Once a trader and his respective coach both feel that the prior is prepared to trade, Paragon facilitates the funding of a live trading account (or multiple accounts) for the trader to begin building his trading business.

KEY VALUE PROPOSITIONS:

NO MEMBERSHIP FEE
NO DESK FEES
NO CONTRACT
ONE MONTHLY TRAINING FEE
1-HR, WEEKLY COACHING SESSIONS
FULLY-FUNDED TRADING ACCOUNTS

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