BY KIARA ASHANTI

Q&A: Joe DiNapoli

Trader Joe DiNapoli talks about trading currencies and applying Fibonacci analysis in the markets.

For many, the notion of trading currencies is a strange one. In fact, a large number of traders have no idea how currencies "work," how they are traded or, worst of all, how much knowledge is necessary to be successful in the currency market.

Joe DiNapoli, author of *Trading with DiNapoli Levels: The Practical Application of Fibonacci Analysis to Investment Markets* (1998, Coastal Investment), is a well-known speaker, both on currency trading and Fibonacci analysis (see "The Fibonacci series," p. 86).

At age 56, he has been involved in the markets for more than 30 years. Since that time, he has seen bull markets and bear markets, and has traded nearly every tradable instrument.

DiNapoli says he was initially attracted to the "puzzle" of the markets. In the early 1980s, he became interested in currencies and has traded in that arena ever since. He liked the simplicity of currencies, among other factors.

"Currencies didn't grow," he says. "They are not a commodity, so I didn't have to worry about things like, say, the weather. Currencies were like bonds, a more purely technical instrument, and S&P's were not available at that time."

We spoke to him briefly about trading currencies online as well as his analysis techniques.

AT: ***The market has obviously changed since you began trading currencies. How do you feel about the changes?***

JD: It's better — much better. Now, you can bypass the floor. If you have a good broker that is trading in real forex (spot currencies rather than futures), then you have a better shot at having a winning trade.

AT: ***The currency market is often billed as being open 24 hours a day, but how realistic is it for people to come home from their jobs and start trading after dinner or after "Letterman"?***

JD: It all depends on their equipment, and where they're getting their quotes. [But] you have to trade at the most active times. I want to be there when there is liquidity. Certainly, that means trading when New York is open, and certainly when Asia is going through its liquid times. I don't trade when it gets quiet.

AT: ***What methodology do you use to trade?***

JD: I use Fibonacci analysis. I actually did not start using it until late in my trading career, about 1984 or 1985. But prior to using Fibonacci, my biggest breakthrough was the Oscillator Predictor, which is a way of determining overbought and oversold positions a day ahead of time. It's a study derived from a detrended oscillator. The detrend is simply the close minus a given moving average — simple, but powerful. The Predictor takes this simple oscillator and projects the overbought and oversold values one period in advance. (*More information on the Oscillator Predictor can be found in DiNapoli's book*.)

I learned early on that capturing profits — that is, taking them using preset profit targets — is the way to go. You get a good position, get an extreme movement and then get out before the market whips back in your face.

AT: ***You've said that not a lot of people know advanced Fibonacci techniques. Is that because it's too complicated? How difficult is it to learn?***

JD: If Fibonacci seems difficult to you, it is because you are not reading the right books. Fibonacci analysis is like bridge building. There are aspects of bridge building that you will find interesting, and you may not even need to learn a lot of it to build a decent bridge. What I do with Fibonacci analysis is relatively simple, but it is an advanced form of a simple approach.

I don't use 90 percent of what's in Fibonacci analysis. I only use a small kernel, and that's what I found to be extremely useful and practical. I focus on just two retracement ratios (.382 and .618) and three expansion ratios (.618, 1.00 and 1.618). The real trick is how those ratios are applied. Terms I've coined like "confluence" and "agreement" combine expansions and retracements in unique ways. There's also the concept of "lineage" which, simply stated, refers to the points from which particular Fib locations were developed. This may sound complicated, but it isn't.

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I'm a very practical guy. I don't get off on esoteric things. There is not much there in terms of stressful math. However, there are books [on Fibonacci] that are written to make the reader think the author is brilliant.

AT: ***What other trading tools do you think work well?***

JD: There are some trend-following methodologies I'm absolutely crazy about. The trend-analysis techniques I use are

continued on p. 88

displaced moving averages (see "Acting vs. reacting," *Active Trader*, June 2001, p. 88) and the MACD/stochastic combination.

Also, you have to use Fibonacci in a context or you're dead meat. First, you need to determine whether the market is going up or down, probably by using a trend-analysis technique. Then and only then do you apply the Fibonacci work.

AT: ***What about methodologies people should stay away from?***

JD: There are certainly indicators I think are not useful, but I do not want to poison anybody's well. It really depends on the individual. Traders have to find methods that fit them.

For example, some people don't like to buy pullbacks, but that's what you're doing when you use Fibonacci analysis. Some people don't like to have pre-calculated profit objectives that get you out of the market, but you do that with Fibonacci.

The more leverage they give you, the greater the chance for you to lose.

If people don't like to do those sorts of things, then Fibonacci is not something they will like. The technical indicator a person uses has to fit his or her personality, otherwise it won't work. And this goes for all types of trading, not just currencies.

AT: ***One of the draws to currency trading is the huge leverage. How do you personally handle the risk that comes with that and how do you think others should?***

JD: Leverage is the big killer. Traders, especially new traders, only consider the upside when it comes to leverage. I rarely use anywhere near the amount of leverage available to me.

Once in a while, if I see something really safe, I will put the pedal to the metal, but not often. Most people just have no idea how to handle leverage. It's great for the brokers, though, particularly in forex shops, because they're taking the other side of the trades. The more leverage they give you, the greater the chance for you to lose.

AT: ***How do you feel about the new generation of online cash currency brokers?***

JD: It's the way to go — if you have a good broker. The forex market has always been unregulated. There is a new law regarding it and they are going to try to regulate the unregulated to some degree. But you have to be very careful.

AT: ***What should you look for in a currency-trading firm?***

JD: There are a couple of really basic things to look for. First of all, if you want maximum safety, see if the firm is registered in another area. For example, a cash currency-trading firm may also have a branch that trades futures. That firm will be registered [as a futures clearing merchant, or FCM]. If you have a broker that is licensed in another area, that helps.

The other thing is word of mouth. If you have questions about a firm, you should ask other brokers and traders. Also, when dealing with a forex broker, you do not want to deal with one that asks you if you want to buy or sell before giving you the quote. If you tell them first, they can give you a quote that puts you at a disadvantage. You want the quote first. Reputation, positive word of mouth, being licensed in another arena — these are the best things to go on [when looking for a brokerage].

AT: ***Which currencies are the best to trade?***

JD: Again, this is a matter of individual preference. The euro, Japanese yen, British pound and Swiss franc are all good. The Canadian dollar and Australian dollar are OK. There are also lots of crosses [cross rates, non-dollar denominated currency pairs] out there that are good to trade. But no matter what you trade, you need to have good techniques. In general, stay away from any market that is not very liquid. However, sometimes a thinly traded currency can be worth trading if your time frame is long.

AT: ***What type of training should a person get before trading currencies? How about reading books?***

JD: You don't read books, you *study* books — the *right* books. Then, when you find a methodology that suits you, you spend the money to go to a seminar. Then you do some very light trading and develop a trading plan.

I don't think the currency market is special. It doesn't matter if you are trading the Nasdaq, S&P or currencies, you need to get a good grip on high quality technical analysis.

AT: ***How much capital should a person have?***

JD: That depends on the person. If you were a billionaire, I'd say $200,000. If you don't have that much to trade, my best guess is at least $10,000, on average. But you have to be very conservative.

The Fibonacci series

The Fibonacci series is a numeric progression in which each successive number is the sum of the two immediately preceding it: 1, 2, 3, 5, 8, 13, 21, 34 and so on.

As the series progresses, the ratio of a number divided by the immediately preceding number approaches 1.618, the "golden mean" found in the dimensions of the Parthenon, the Great Pyramid and many natural phenomena. Some traders use 1.618, its inverse .618 (.62) and other ratios (such as .38 and .50) to calculate price targets and retracement points.

For example, if a stock rallied from 25 to 55, potential retracement levels could be calculated by multiplying the distance of the move (30 points) by Fibonacci ratios — say, .38, .50 and .62 — and then subtracting these results from the high of the price move. In this case, levels of 43.6 (40 [55 - (30*.38)]), 40 [55 - (30*.50)] and 36.4 [55 - (30*.62)]) would result.