10-001
COMMENT
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From: THE Sandor Swartz <sand4@hotmail.com>
Sent: Tuesday, January 19, 2010 1:37 PM
To: secretary <secretary@CFTC.gov>
Subject: Regulation of Retail Forex

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To whom it may concern,

I believe that having changed the maximum leveraged allowed from 400 to 1 to 100 to 1 near the end of last year was not unjustified. But changing it to 10 to 1 is taking it way too far. First of all, the volatility of most currencies is way, way less than stocks. In the last year, the dow has been as low as 6500 or so and as high as 10500, the high well over 50% higher than the low, and in all that time, the USD/JPY has hardly ever left the range between 90 and 100, hardly 10% above the low. Even the euro, more hit by speculation, has only been down to 1.25 and up to 1.50, which is 20% higher than the low. When the dow changes by 1%, some high-alpha stock may change by 10%. And when something doesn't change as much, it is only natural that more or less of it must be purchased to do anything. Just like with a volatile stock, the options available for far out of the money strike prices will be much higher than the same percentage out of the money for a low-alpha stock, because with the volatile stock, there actually is a decent chance of the price making it up there.

Of course the volatility isn't the only part. The other part of the equation is the bid and ask difference. Call it spread, or commission is what it really is in the case of forex, the fact is this: for currencies, it is ridiculously small compared to stocks. Most of it I think is actually profit by the broker. I'm not sure whose pocket the spread ends up in. I'd be very interested to know if you know the answer to that. But whatever the case, say you buy a typical dinky little stock because it makes it onto the top gainers list (a sure way to lose your money) with a price of 10 dollars a share and a volume of, say, 100 thousand to a million. You could very well see a bid of 9.60 and an ask of 10.00 on that. Which means if the brokerage needs to force you to get rid of it in a hurry if you've overleveraged yourself, just on top of the natural obscene volatility you can expect from such a stock (it's more like a game of poker than investment in anything), they can only get 9.60 back on each share; they'll lose 4%. With currencies, for instance the USD/JPY again, it's more than one hundred times smaller than that. More like 0.02% What this MEANS is that the consequences of a disaster in which everyone's stop orders go through will not be like 1929 when people were leveraged 100 to 1 on STOCKS. Currencies have way sturdier constitutions than stocks, and the market won't crash, it will only go down (or up) a few extra points, because there will be no problem getting everyone's orders through. 2007-2009 was time of greatest volatility in the history of the forex. I can see that when I plot my USD/JPY 1 minute data from July 2007 to Feb. 2009 in matlab. It simply gradually goes up and up, making a parallelogram roughly twice as tall at the end as at the beginning. And in those most severe of condition, did the forex brokers go out of business because they allowed their customers to leverage so much that by the time their accounts were liquidated, they were far into the negative? No. Even leveraged 400 to 1 with liquidation at a quarter of that level, it would take a very slow response on the part of the broker to let it get negative. And since it's probably all automated, it's not like it's at the mercy of someone at the brokerage hitting a button in time, it will just be done by an always-vigilant computer program right away.

The entire appeal of the forex market is that you can leverage something but they're NOT charging you interest on that loan like greedy stock brokers do. They can do this because

they'll have a lot of customers with a lot of EUR/USD sitting in their accounts and a lot of customers with -EUR/USD sitting in their accounts, so the brokerage has few net holdings either way, and simply charges neither customer out of courtesy. While the stock broker has one customer leveraged 2:1 on something and someone else is shorting that something -2:1 and for holding nothing except getting to keep both customers' money earning interest for the brokers, they get to charge them both customers interest on a loan! Now I think THAT'S a practice you should bring to an end. It's very sleazy when you think about it. A stock broker in other words should have to charge the same interest rate, but NEGATIVE, for customers who are shorting something. Because they shouldn't be able to charge, between the sum of both parties, a net interest for a loan when he's not doing anything total and he's the one borrowing the customers' money! But back to the forex, indeed, they don't do that. BUT by the same token, they also don't give you any interest on money sitting in your account. Imagine if you brought the ratio down to 1:1. Then it would be exactly the same as just trading in hard cash dollars for yen bills, and stuffing them in your mattress. Or almost the same, because you couldn't short the yen 1:1 with real money. Try this. Go to a bank. See what the spread is for actual paper money. It won't be 2 or 3 pips, I'll tell you that! It'll be perhaps 100 times that. Do you know why? The reason is that the forex broker can only make it so low because he's constantly dealing with customers leveraged 100 to 1 each way. In other words, if you bring it down to 10, you can expect eventually brokers will no longer off 2 pip spreads. It'll be 20. And then things will be the same as before mathematically, just over 100 times the time scale (since the amount it changes will be proportional to the square root of the time scale). But like I was saying, you're also not earning any interest on the money you have sitting in the forex account. If you have to put 1000 dollars down to buy ONE USD/JPY 10k mini-lot instead of 100, that's 900 dollars that could have been sitting in a bank earning interest. And that's going to take the appeal out of the forex. The lower you make the maximum leverage, the more and more trading the forex will be like getting wads of cash and stuffing them in a mattress! 400:1 to 100:1, I can understand that. Force people to be responsible. In all my computer simulations, only under the best of conditions (like when I make the spread 0) is the optimum amount of daringness to even leverage it 200:1 (and I get amazing results if I set the spread to 0 by the way - I could turn one dollar into 100 in the average week, and even if spreads were one tenth as large, I could turn 1 dollar into roughly 10 in the average week - but the thing is, if the spreads WERE that low, the market would react and the method probably wouldn't work again). There's no rational reason to leverage it higher than 100:1, unless you happen to be in the possession of a delorean equipped with a flux capacitor. But I tell you, the forex market will lose its appeal if you do this. And when it loses its appeal, it will become more illiquid. And when it becomes illiquid, the spreads will go up. And when that happens, it will be JUST as risky as it is now, just with a whole lot less potential to succeed in, and when the market reacts and becomes just as risky under 10 to 1 leverage as it is now under 100 to 1, you'll all be standing around wondering if you should lower it to 3 to 1, and if you do that, the market will react again and the same thing is going to happen. Of course, this is only what would happen if everyone on Earth had this limitation. But it's still the wrong thing to do, in one region or all of them together.

I appreciate it if you have listened to my arguments. Thanks for your time.

Sincerely,

Sandor Swartz

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