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FOREX

made easy

UNDERSTANDING THE BASICS

An educational tool by Blackwell Global

Contents

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What is Forex?

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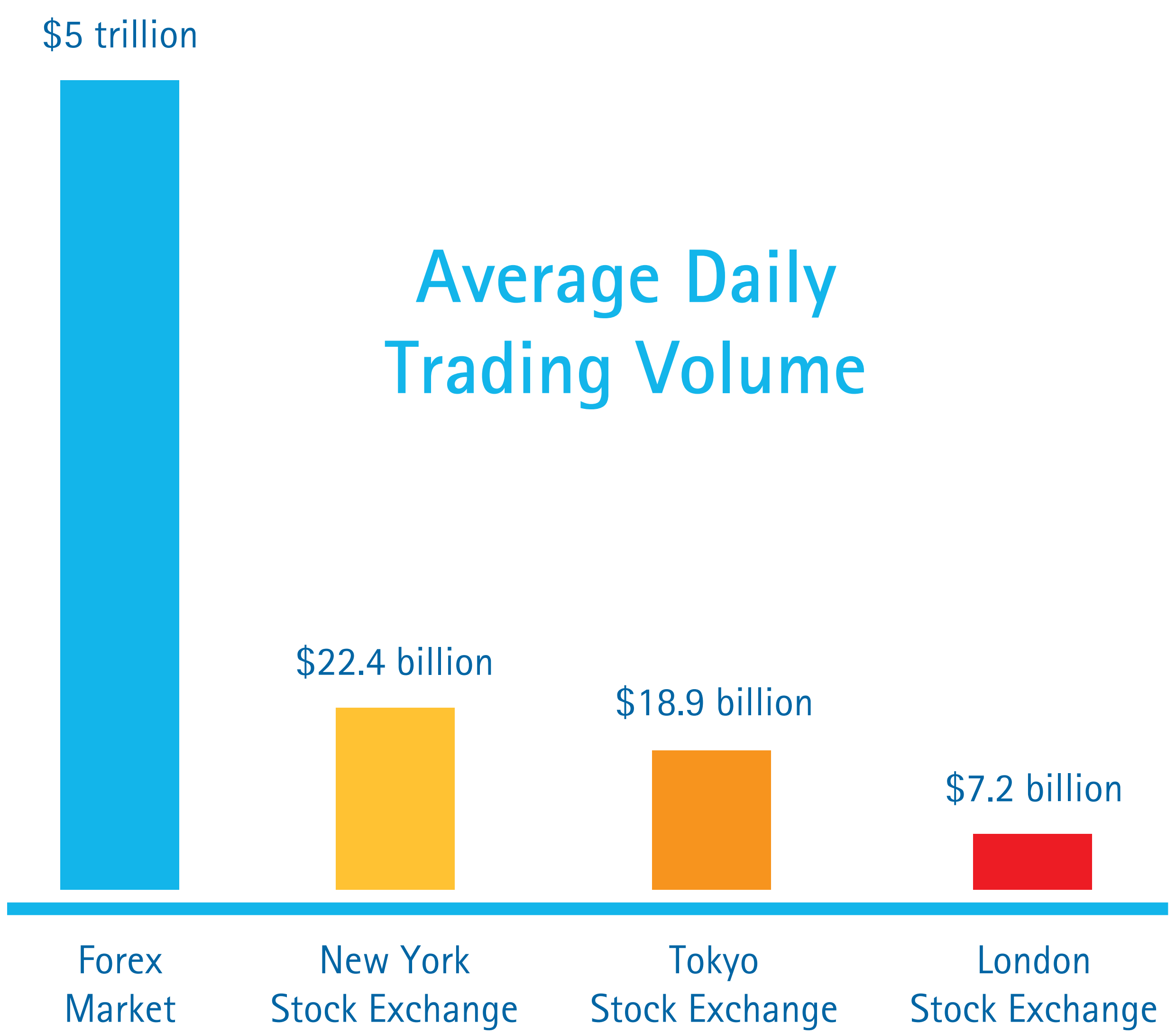
Foreign exchange / Forex / FX is the domain in which the exchange of money between two countries takes place at a mutually agreed rate.

Traders can profit on the movement of the value of one currency compared against another.



Forex is the largest financial market globally as it is used by a variety of participants from all over the world, with a daily turnover of USD 5 Trillion! These include institutional investors like Morgan Stanley and Citi group.

The central banks of the world intervene and monitor the health of the global financial markets, namely, the Federal Reserve (Fed), ECB and the Bank of Japan, just to name a few.

Following them are exporters and importers, and companies who have operations abroad and need to exchange currency to pay salaries and expenses.

Finally there are retail investors, the small time speculators who make money out of the markets every day. There is no larger and more liquid financial market than the forex market.

The major exchanges like the NYSE and the Tokyo Stock Exchange pale in comparison, as they only account for USD 22.4 billion and USD 18.9 billion trading volume per day.

Currencies

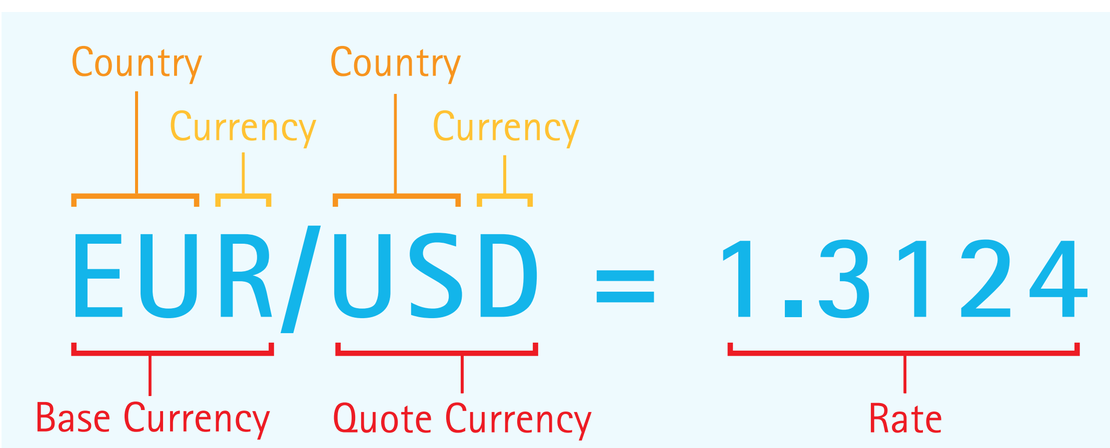
The 8 most traded currencies:

Country	Currency	Abbreviation	Symbol	Nicknames
United States	Dollar	USD	$	Greenback/Buck
Eurozone	Euro	EUR	€	Fiber
Japan	Yen	JPY	¥	Yen
United Kingdom	Pound	GBP	£	Cable
Australia	Dollar	AUD	$	Aussie
Switzerland	Franc	CHF	Fr	Swissy/Swissie
Canada	Dollar	CAD	$	Loonie
New Zealand	Dollar	NZD	$	Kiwi

Currency Pairs

Currencies are always traded in pairs using their official abbreviation.

In this case, 1 EUR is worth 1.3124 USD.



The first currency on the left is the base currency, while the other currency on the right is the quote currency. This shows how much 1 unit of the base currency is worth against the quote currency.

Most countries have their own currency like the U.S. and Australia, and these currencies are traded and exchanged globally on a daily basis.

The U.S. dollar, which is the top currency on the above table, is the world's most traded currency and is commonly referred to as the global currency.

This is due in part to its nature as the global standard amongst central banks and how liquid and recognisable it is. To put it in a more global perspective, the U.S. dollar accounts for 80% of all forex transactions globally.

As you can imagine, there are a lot of U.S. dollars in a 5 trillion dollar daily market.

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Major Pairs

Currency pairs that involve the USD, which are the most commonly traded in the forex market.

SOME EXAMPLES

EUR/USD	USD/JPY	GBP/USD	USD/CHF	USD/CAD	AUD/USD	NZD/USD

Historically, an individual who wished to exchange a sum of money into a different currency would be required to first convert that money into U.S. dollars, and then convert it into the desired currency.

Minor Pairs/Cross Pairs/Major Crosses

Currency pairs that are commonly traded but do not involve the USD.

SOME EXAMPLES

EUR/CHF	EUR/GBP	GBP/CAD	GBP/NZD	AUD/JPY	AUD/NZD	CAD/CHF

Minor Pairs can be further grouped into crosses such as Euro Crosses, Yen Crosses, Pound Crosses, Aussie Crosses etc.

Exotic Pairs

These pairs are not commonly traded and are generally only offered by specialist FX companies.

The reasoning is that exotic pairs are generally very illiquid and have very large spreads, which makes it more challenging for speculators to trade.

SOME EXAMPLES

Country	Currency	Abr
Hungary	Forint	HUF
Israel	Shekel	ILS
Mexico	Peso	MXN

Country	Currency	Abr
Saudi Arabia	Riyal	SAR
South Africa	Rand	ZAR
Turkey	Lira	TRY

Exotic currencies are usually from developing countries with emerging markets such as certain parts of Asia, the Pacific, the Middle East and Africa.

Understanding the Terms for Trading

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Short (or Short Position)

The sale of a currency with the expectation that it will fall in value.

Long (or Long Position)

The purchase of a currency with the expectation that it will rise in value.

Margin

Margin is the the amount of money required in your account to maintain your market positions, in order to cover some or all of the credit risk associated with borrowing money on leverage.

Margin Call

Margin Call is a level set by your broker that defines a minimum amount of money required to trade in the market. When your account's value falls below this level, you will be asked to deposit additional money to maintain your positions. Alternatively you can close some of your positions to reduce your required margin.

Stop Out

In the event you are unable to top up your account after hitting Margin Call, a Stop Out may occur if your account value depreciates to the Stop Out level. Once your account falls below the Stop Out level, your positions will be automatically closed to prevent further loss to your capital.

Leverage

Leverage is a facility offered by the broker, to help the trader trade large amounts while only holding a small amount of capital compared to what you are trading.

Your leverage	1:100
Your capital	$1,000
Your trading amount	$100,000

Swaps

Swaps, often referred to as Rollover Interest, are charged when holding onto a position overnight due to the difference in interest rates between the base currency and the quote currency.

As forex trades are settled in two business days from inception, any open positions held from Wednesday to Thursday on a trade date basis will be calculated as three times the swap rate value. The extra calculation is to cover the interest that would normally have been charged on Saturday and Sunday when the market is closed.

Carry trades involve selling a currency with a low interest rate, then using it to purchase a different currency with a higher interest rate. This is done to collect the profit from differences between the interest rates.

Pips and Profit

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Pips

A pip is the 4th decimal place in the currency value.
For the Yen, it would be the 2nd decimal place.

position of decimal place:

1st 2nd 3rd 4th

EUR/USD = 1.3124

pip

If the EUR/USD currency pair moves to 1.3128, it has gained 4 pips.

Blackwell Trader quotes currency pairs to the 5th decimal place (except for cross currency pairs with Yen, which are quoted to the 3rd decimal place). This allows for accuracy and transparency in our price offerings for forex traders for the best spreads, compared to a four-digit pricing/two-digit pricing where trading figures are 'rounded up' or 'rounded down'

Profit

By now you're probably starting to grasp the basics of it, but how do you make profit? Well the answer is that profit comes in pips.

EXAMPLE

You bought EUR/USD 1.3214

You sold EUR/USD 1.3228

You made 1.3228 – 1.3214 = 14 pips

You traded 1 standard lot = 100,000 units

1 pip in EUR/USD = $10

Your profit is 14 pips x $10 = 140 USD

*Pip values will always differ between pairs.

By convention, the value of a pip is always based on the quote currency.

Spread

With all trading, there is a cost for entering in and out of positions you have in the market. In forex, you are charged the difference between the bid and ask price. This is called the spread.

EXAMPLE

EUR/USD Bid: 1.3241

Ask 1.3243

The spread is currently 2 pips.

Your trade will cost 2 pips.

Commission

Some brokerages may charge commission on forex trades.

Blackwell Global does not charge commission when trading forex.

Types of Orders

Entering Your Trade

Market Order

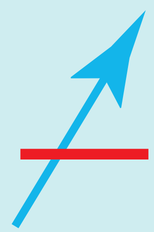
An order which is made immediately through the MT4 platform. This gives you the best available price in the market for whatever position you are taking.

Pending Order

An order which can be placed to be executed at a specific price. The picture below helps detail these orders:

Buy STOP

An order placed above the current market price to long at the specified price

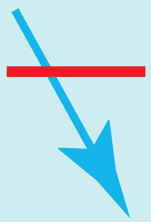


Buy LIMIT

An order placed below the current market price to long at the specified price

Sell STOP

An order placed below the current market price to short at the specified price



Sell LIMIT

An order placed above the current market price to short at the specified price

Exiting Your Trade

Market Order

Closing an order immediately which was made previously through the MT4 platform.

Take Profit

An order which you can put on a trade after you have placed it, which allows your trade to automatically close once it hits a certain price in the market that is favourable to you.

Stop Loss

This order exists to protect against losses accumulating out of a comfortable range. If the currency pair moves against you, a stop loss order can be used to automatically close your trade at a specified price and limit your losses.

What makes FX superior?

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Forex	Equities / Bond Markets
• 24-hour trading	• Only open during the exchange's business hours
• Typically no commission on trades, and very tight spreads.	• Commission paid on every trade executed
• Fast execution of orders, with 99.9% of orders filled within seconds	• Execution of order takes place only when there is a willing buyer
• High liquidity at all times, as proven during the global financial crisis	• Liquidity depends on market sentiment
• Ability to profit from a rising or falling market	• Only can profit from a rising market
• Lower margin requirements	• Higher margin requirements with Equities and Bonds
• Leverage of 1:100 to 1:200	• Very low leverage in Equities
• No middle man involved, hence lower transaction costs	• High transaction costs in comparison

Over the last few years the forex market has seen rapid growth. During the recent global financial crisis in 2007, substantial weaknesses of the global financial system were revealed. Faith in these once rock solid markets has diminished, as they were revealed to be illiquid during crunch periods. Investors who once played the stock market realised that stock prices were only as good as the value that someone would pay for them, and as prices plummeted so did liquidity, leading to huge losses for many investors.

This has fuelled the move to forex trading, contributing to the rapid growth of FX trading.

The market with the highest liquidity:

This is the forex market's biggest advantage. You can expect most orders to be filled in under a second as there is always a buyer and seller in the forex market. With such high liquidity, it means that spreads are not expensive and market manipulation is very hard and rare.

World Economics

The major world economies wield huge power on the FX markets and most currency pairs trade on the USD, as it is the largest economy in the world. Some of the major economies include the US, China, Eurozone, Japan, Britain, Switzerland, Australia and Canada.

All of these economies have central banks, such as the FED for the US and the Bank of Japan for Japan. In addition to these central banks, there are players such as the World Bank and the IMF that can have a large influence over the FX market.

The FED

The Federal Reserve of the United States of America is the largest central bank in the world, and the most powerful when it comes to moving markets. Whenever the FED chairman speaks, traders around the world pause and listen, and for good reason. It is capable of causing extreme market movements as was seen in the global financial crisis.

The ECB

The European Central Bank oversees the Eurozone on monetary policy and the health and balance of capital markets in Europe. Currently headed by Mario Draghi, it is also capable of moving the market heavily. However it is not as powerful as the FED. Economic policy is a tricky process in the Eurozone as it requires all the members to agree before action can happen.

The IMF

The International Monetary Fund is the watchdog of the economic world. It provides funding for countries that are in need of loans due to their struggling economies or are under extraordinary circumstances for which they need capital to rescue themselves. It has played a huge role in the last few years, helping to bail out Greece and providing monitoring for the Euro Crisis.

Economic Policy

Fiscal policy is a buzz word thrown around in forex which can be easily confused with monetary policy. The main difference between the two is that fiscal policy is executed by governments and not central banks. An example of this would be tax policy or budgets for large governments such as the U.S. federal government. We have seen the effects on the markets from drastic fiscal policy when the debt ceiling in the U.S. was not raised for some time.

Monetary policy is economic policy carried out by the central banks of a country such as the FED or ECB. Examples of monetary policy can be large asset purchases, adjusting of reserve rates, adjusting of interest rates, and expanding monetary supply. All of these policies can have either negative or positive effects on the economy.

Understanding the Impact

1) Fiscal policy is executed by governments while monetary policy is only executed by central banks which are generally separate from governments.
2) Profit can be made from these movements by fully understanding the net impact of these policies on the economies
3) Pay attention to the major players via economic news to make money in the FX market.

Conclusion

Trading forex is a highly dynamic exercise, where there is a strong need to understand the technical aspect of trading, as well as to be aware and constantly updated about political conditions, economic factors and market psychology.