

LET'S GET TO KNOW

FOREX

Introduction

Whether you're a power trader or a financial newbie, you're likely to hear just about anything—market movements, outlooks and stocks—being described as bullish or bearish.

While traditional bull markets offer traders the opportunity to buy most financial products and sell them at a higher price, traditional bear markets have heavy restrictions on shorting, or selling a financial product to buy it back at a lower price.

Fortunately, there is a financial market called forex that gives traders the choice to enter a buy or sell trade whenever they want, without those restrictions.

Let's talk about the bulls and the bears.

A Bullish Trader

Buys a financial product to sell at a HIGHER price.

In a traditional bull market...

Stocks and bonds are rising in value. Traders buy to enter the market and find profit potential.

A Bearish Trader

Sells a financial product to buy at a LOWER price.

In a traditional bear market...

Stocks and bonds are declining in value. Traders sell to exit the market and minimise losses. Most traditional markets don't allow traders to sell to enter the market to find profit potential.

In The Forex Market

One currency is always strengthening against another (bullish), and therefore, one currency is always weakening against another (bearish). Because of this, you have equal opportunity to buy or sell to enter the market.

It's time to rethink everything you know about bulls and bears.

You may not realise it, but the bulls and bears aren't at odds. In fact, they represent two opportunities to find profit potential in the forex market.

What is forex trading?

Also known as foreign exchange or currency trading, forex is one of the largest markets in the world. In forex trading, traders hope to generate a profit by speculating on the value of one currency compared to another. This is why currencies are always traded in pairs—the value of one unit of currency doesn't change unless it's compared to another currency.

Currency pairs appear like this:

EUR/ USD

The first currency listed is the base currency.

The second currency is called the quote or terms currency.

A sample quote for this pair could be:

1.3038

The base currency is always worth one. The quoted price shows how much of the quote currency you'll get for one unit of the base currency. So in this case, 1 EUR is worth approximately 1.30 USD.

Two Trade Opportunities

SCENARIO 1: BUY TRADE

If you believe the current value of the euro is strengthening against the US dollar, you might enter a trade to buy euros in the hopes that the currency's value will become stronger compared to the US dollar. In this scenario, you think the euro is bullish (and the US dollar is bearish).

SCENARIO 2: SELL TRADE

Conversely, if you think the current value of the euro will weaken against the US dollar, you might enter a trade to sell euros in the hopes that the currency's value will become weaker compared to the US dollar. In this scenario, you think the euro is bearish (and the US dollar is bullish).

Did you know?

The buy or sell action you take to enter a trade always applies to the base currency. The opposite action automatically applies to the quote currency. So, if you buy the EUR/USD, this means you're buying euros and selling US dollars. If you sell the EUR/USD, you're selling euros and buying US dollars.

Even if You're New to Forex, You May Have Traded Currencies Before.

For example, if you've ever travelled to another country, you had to exchange your native currency for that of the country you were visiting. At that time, you probably realised that your one dollar was not exactly equal to one unit of the other country's currency: its value was either more or less.

Exchanging currencies isn't just for travellers. The price difference is something you can trade.

In the global economy, thousands of business transactions take place every day that require organizations to exchange the value of one currency for that of another. When a United States manufacturer buys Japanese steel, they need to convert dollars to yen to pay the bill. A British clothing retailer converts pounds to euros to pay for garments from a French textile company. In every exchange, prices need to be adjusted because one currency is typically weaker (has less value) while the other is stronger (has more value).

With so many changes taking place, currency values are rarely static. Throughout the course of the day, the value of one currency compared to another can change in response to political news, economics and interest rate changes. This means that a currency that was weaker than another in the morning may be stronger by the afternoon. These frequent changes in the value of currency are what drive forex trading and a trader's profit potential in the currency markets.

Did you know?

When you exchange currencies while travelling in a foreign country, you are technically selling your currency and buying that of the country you are visiting.

The forex market is big. Really big.

While the worldwide bond and stock markets have a daily volume in the billions of dollars, the forex market has a daily volume of over US\$4 trillion. This leads to more trade opportunities.

A high volume helps traders execute trades that get them in and out of the market quickly. This ability to enter or exit trades with little hassle is called liquidity, and it can help provide you with more profit potential.

Forex can be traded 24-hours a day, 5.5 days a week. With stocks, bonds and most other financial products that are traded on exchange, you can only make trades during the exchange's business hours. Fortunately for forex traders, currencies are free of this restriction and can be traded day or night—24 hours a day, 5.5 days a week. Here's why.

At 5pm ET on Sunday evening, financial markets open in the Pacific (Australia, New Zealand, Japan and various Asian countries). As those begin to close, markets in the Middle East and Europe start to open. When Europe is in mid-session, financial markets across the Americas open. This pattern continues until 5pm ET on Friday when the American financial markets close for the weekend. The consistent closing and opening of markets around the globe provides around-the-clock access to traders, 5.5 days a week. This is why you may hear many people refer to forex as a global market.

Did you know?

Forex trading is so popular that it makes up 95% of the foreign exchange transactions on the market. Conversion transactions only make up a mere 5% of the forex market.

Who trades forex?

You'll hear of everyone from big banks and hedge funds to small- and medium-sized traders talking forex. And since the markets are open longer than traditional markets, you can trade when it's convenient for you.

What currencies can I trade?

You can trade almost any currency—depending on which currency pairs your dealer offers. Tradefair has over 120 pairs to choose from. As a new trader, however, you will probably make your first trades with eight of the most commonly traded and exchanged currencies in the world.

AUD	Australian Dollar
CAD	Canadian Dollar
CHF	Swiss Franc (stands for Confederation Helvetica Francs)
EUR	European Union
GBP	Great British Pound
JPY	Japanese Yen
NZD	New Zealand Dollar
USD	United States Dollar

When you start to trade, you'll begin to recognise the eight major currencies by their code.

Currency codes are always three letters: the first two identify the country name and the last letter usually identifies the name of the currency.

The exception to this rule is the Euro (EUR), which is used in multiple countries in the European Union.

Pips, Lots & Leverage

By now, you may feel comfortable and even a little excited about trading forex: you know who trades it, when they trade it, and what currencies are available. In this section, we'll discuss some concepts you need to know before you trade your first currency pair.

Why are currency pair prices displayed with four decimal places?

Nearly all currency pairs display their prices like this. A few, such as the Japanese yen, display two decimal places. No matter what currency pair you're trading, the last number behind the decimal always represents a pip, the smallest unit price that can change for the currency pair. As you trade, you'll track your profits (or losses) in pips.

EUR/USD PRICE EXAMPLE

1.3037

Represents one pip

One unit of movement represents one pip. That may seem small and you may be wondering how forex can be worthwhile if all you're speculating on is a small fraction of a currency. Fortunately, forex is leveraged and traded in lots.

What is a lot?

In forex, a lot is a standard unit of measurement. At most forex dealers, one lot usually equals 100,000 worth of currency. Whenever you place a trade, you start with one lot. Fortunately, you don't need £100,000 in your account to trade the EUR/USD. Currency pairs can have a leverage ratio of up to 400:1. This means you can control a large position (£100,000) with a small amount of money (£250).

Many traders find the leverage that most forex dealers offer very appealing. Nonetheless, you should know that

trading this way can also be risky. It can produce substantial profits as easily as it can cause substantial losses.

So how do pips, lots, and leverage work together?

Let's imagine that you just closed a successful, one-lot EUR/USD trade. You earned 20 pips.

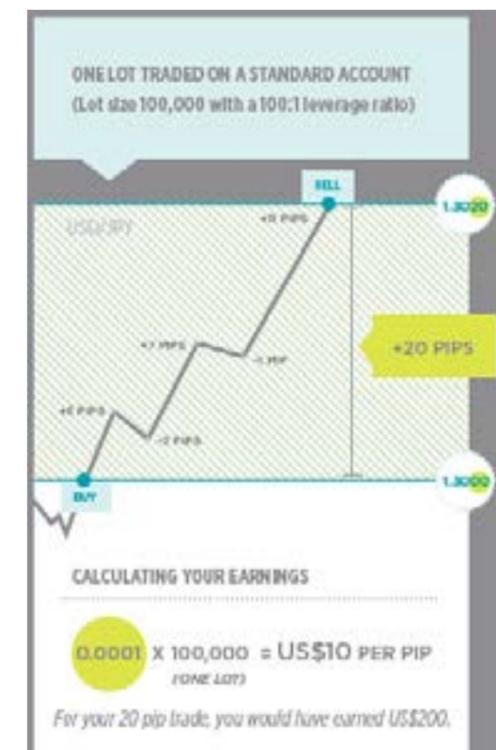
Because you're trading the EUR/USD, that means:

$$0.0001 \times \text{US\$}100,000 = \text{US\$}10 \text{ per pip}$$

For your 20-pip trade, you would have earned US\$200.

Not all of the pips you'll earn will be worth US\$10. The value of a pip depends on the lot size of your trade, how many lots you're trading, the currency pair and your account currency.

While you can manually calculate this or use online pip calculators to learn the value of a pip before you trade, most trading applications, like the DealBook® platform, automatically calculate pip values and convert them to the currency you're trading.



Four Steps to Making Your First Trade in Forex

Now that you know a little more about forex, we'll take a closer look at how to make your first trade. Let's say that you opened an account with Tradefair. Before you trade, you need to follow a few steps.

1. Select a Currency Pair

As you learned in earlier examples, the nature of forex trading is to exchange the value of one currency for another. In other words, you will always buy one currency while selling another at the same time. Because of this, you will always trade a pair of currencies.

Most new traders start out by trading the most commonly offered pairs of major currencies, but you can trade any currency pair you want, as long as you have enough money in your account. For this walkthrough, we'll look at the EUR/USD.

2. Read Its Quote

Dealers will often list a price with two different numbers. For example, when you look up the EUR/USD, you'll see the forex quote is listed as:

The first rate (1.3038) is the price at which you can sell the currency pair. The second rate (1.3040) is the price at which you can buy the currency pair. The difference between the first and second rate is called the spread. This is the amount that a dealer charges for making the trade.

3. Analyse The Market

Research and analysis should be the foundation for your trading endeavours. Without these, you're operating largely on emotion. This doesn't typically end well.

When you first start researching, you'll find a wide wealth of forex resources—which may seem overwhelming at first. But as you research a particular currency, you'll find valuable resources that stand out from the rest. You should regularly look at current and historical charts, monitor the news for economic announcements, consult indicators and perform other analysis activities. We'll talk more about specific types of research later on.

4. Pick Your Position

If you've traded stocks, bonds or other financial products, you know that you can usually only speculate on one direction of the market... up.

Forex trading is a little different. Because you are buying one currency while selling another at the same time, you can speculate on up AND down movement in the market.

- With a buy position, you believe that the value of the base currency will rise compared to the quote currency. If you're buying the EUR/USD, you believe the price of the euro will strengthen against the dollar. In other words, you believe the euro is bullish (and that the US dollar is bearish).
- With a sell position, you believe that the value of the base currency will fall compared to the quote currency. If you're selling the EUR/USD, you believe the price of the euro will weaken against the dollar. In other words, you believe the euro is bearish (and that the US dollar is bullish).

Let's see how these would work. Imagine that you did some research and decided to enter a trade.

Entering a Buy Position

The current price for the EUR/USD is 1.3038/40. You believe that the euro is bullish, so you decide to enter a buy position for one lot of the EUR/USD. Because you are buying, your trade is entered at the price of 1.3040 to cover the spread.



Now, let's say that later in the day, you look at your position. The EUR/USD is now at 1.3072/74. Your trade has gained 32 pips. You decide to close your position at the current sell price of 1.3072 and take a profit.



Entering a Sell Position

Let's back up a moment and look at that scenario again. Imagine now that you believe the euro is bearish. You decide to enter a sell position for one lot of EUR/USD. Because you are selling, your trade is entered at the price of 1.3038.



You look at your position later in the day and discover that the EUR/USD is now at 1.3072/74. Your trade has lost 36 pips. You decide to close your position at the current buy price of 1.3074, to cover the spread, and accept your losses.



Anticipating, Planning and Analysing: Three Skills You Need To Become a Forex Trader

As you can see from the sell example, making a forex trade can be extremely risky. Like doing anything that takes risk, however, you can take precautions to try to minimise its impact. In forex, there are three skills you can develop to help you manage your trading risk: anticipating, planning and analysing.

Anticipating: How do I handle risk?

It's important to realise that even the best forex traders have losing trades. While you may make some very successful forex trades, you will also make some losing trades. Fortunately, there are a number of things you can do to anticipate risk.

1. Protect your position with stops, limits and other order types.

There are a number of order types, such as trailing stops, Parent and Contingents (P&C) and Order-cancels-order (OCO) designed to help traders manage risk and protect potential profits.

2. Set proper levels.

You might say that setting a stop is an art; you need to make sure that your stop is set so that your trade can handle smaller jumps and drops in price while protecting you from losing your shirt if the market doesn't go your way. A stop that's too narrow may lead you to re-enter the market, causing you to get stopped out again. That can cause more damage to your account balance than if you entered a stop that was too wide or no stop at all.

3. Check your emotions.

Sometimes, the factor that determines how successful your trade will be isn't the amount of research you did, but your mind-set at the time. As Tradefair's Technical Analyst Bradley Gareiss says, "Psychology is so important that even the best information can be distorted by a poor mind-set." As you trade, try to stay objective and calm. Even if you have a losing trade, resist the urge to enter another trade to win your earnings back.

4. Create a trading plan and stick to it.

A good trading plan is crucial to your trading success. Not only will it help you meet some of your goals, it will define the way you trade, what you're willing to risk and how you will protect yourself when a trade doesn't go your way.

Planning: How do I create a trading plan?

Face it. Without a plan and a rules-based approach to trading, you are simply trading by the seat of your pants. It may seem to work for a while, but self-doubt and/or greed will ultimately get in the way of being consistently successful.

A trading plan serves as a steady anchor in chaotic markets, helping you forecast when to enter and exit the market. Best of all, it's fairly easy to create. The following steps may help you get started.

- A. When constructing a trading plan, ask yourself:
 - a. Will I trade only one specific currency pair or many?
 - b. Will I trade on a daily basis or hold my positions for days or longer?
 - c. How much do I want to make?
 - d. How much am I willing to lose per trade?
 - e. If I trade on a daily basis, how many consecutive losses will I tolerate before I stop for the day?
 - f. How will I analyse the markets? Will I look at news and other events? Will I examine charts and price movements?
 - g. How will I use stops to help control my risk?
 - h. Will I have one profit target or multiple targets?

- i. What kind of profit can I reasonably expect to gain?
- B. Using your answers, write out a short but detailed plan of action plan.
- C. Now, comes the hardest part—sticking to your plan. Try keeping a diary of every one of your trades. It will force you to follow your rules and avoid impulsive trading as much as possible.

Analysing: How will I analyse the markets?

You may have found making your trading plan fairly easy. But one question may have had you scratching your head, "How will I analyse the markets?" One of the most common ways is through the use of price charts.

What are price charts?

Price charts plot the recent prices of a currency pair on a graph and provide a snapshot of market movements over a particular period of time.

Line Charts

Line charts are one of three common chart types that most traders use. They provide a quick way to view the changes in price movements over a period of time.



Bar & Candlestick Charts

Bar and candlestick charts provide an easy-to-analyse appearance that displays detailed information about the price movements of a currency pair.



Bar chart



Candlestick chart

Each bar or candle on the chart is defined by four price points (high, low, open and close). The length of the bar or candle represents the level of trading activity for a specified period. For example, on a chart with a ten-minute time scale, a bar or candle would represent all of the trading activity of the market in a ten-minute period. When the price of a particular market rises, the bar or candle appears one colour (usually green) and when the price of that market drops, the bar or candle appears another (usually red).

Most traders switch between different time frames so that they can compare market movements and verify trends. For example, in the trading platform, you can select to view charts with time frames as small as a tick all the way up to one year.

What is technical analysis?

If you're familiar with trading other financial products, you know that traders tend to hold on to their positions for as long as the market moves their way. When they lose confidence in the market, they tend to reverse or close their positions quickly.

Technical analysis is the study of repeating patterns and movements in the market caused by the pattern-like behaviour of traders. Technical analysis is used to monitor the current and historical price movements of a currency pair, help determine market trends and forecast potential entry and exit points for their trades.

Because no two traders are alike, there are hundreds of technical analysis tools and methods to choose from. Some of the most common are:

Support and Resistance Levels

Support levels are points that market prices drop to but don't frequently break through. Conversely, resistance levels are points that market prices rise to but don't frequently break through. Prices usually continue to hit these levels until they break out, forming new support and resistance levels. Tracking these levels can give you an idea of where to set stop and limit points.



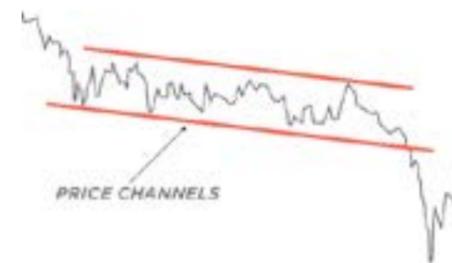
Indicators

These display trend lines either over the recent market movements on a chart or in a separate area below the chart. Bollinger Bands, Average Directional Index (ADX) and Moving Averages are all examples of indicators. Indicators can be either lagging (analyse past market price movements) or leading (forecast future price movements) and can help you see market direction.



Patterns

A chart pattern is a series of price points that move in a particular arrangement and, once completed, forecast market movements. Some common patterns are flags, channels and triangles. You can also plot more complex patterns, such as ABCD patterns or Fibonacci levels. Charts patterns can help you see trends in the market.



What is fundamental analysis?

Earlier in this guide, you learned that the value of a currency pair changes in response to news, interest rate changes, government decisions and other events. As you watch the charts, you'll notice that events and news on a particular country's or region's economy can cause markets to shoot up or down dramatically.

Fundamental analysis traders track these political, social, and economic forces to forecast whether the value of a currency will go up or down.

Many new traders will develop their fundamental analysis skills by following news events and tracking scheduled economic announcements. But there will be times when the price movement of a market won't behave as your fundamental analysis may indicate. That's where it becomes important to incorporate technical analysis into your strategy as well.

Did you know?

As you begin to follow economic announcements, you may understand why some events—like the consumer price index—may cause markets to move. But you may wonder why it's important to follow lesser events, like the food price index. Usually, a major event provides an indication of the state of the economy. But traders follow lesser events because they provide an indication of upcoming major announcements. For example, a jump in food prices may mean the consumer price index will jump as well.