Foreign Exchange

COURSE1

Admin
NIVANFX

TABLE OF CONTENT

WHAT IS FOREX?

1. Introduction to Forex

Forex, or the foreign exchange market, is the global financial market where currencies from different countries are traded. It is the largest and most liquid financial market in the world, with a daily trading volume of over $7.5 trillion. The forex market allows individuals, businesses, and investors to exchange one currency for another, with the goal of making a profit from the fluctuations in exchange rates.

2. The Foreign Exchange Market

The forex market is a decentralized, over-the-counter (OTC) market, meaning that there is no central exchange or physical location where currency trading takes place. Instead, the market is made up of a network of participants, including banks, financial institutions, corporations, and individual traders, who engage in currency transactions 24 hours a day, 5 days a week.

3. Exchange Rates and Currency Pairs

The value of one currency relative to another is known as the exchange rate. Currency pairs are the basic unit of trading in the forex market, where one currency is bought and the other is sold. The most commonly traded currency pairs are referred to as the "major" pairs, which include the U.S. dollar, euro, Japanese yen, British pound, and Swiss franc.

4. Participants in the Forex Market

The forex market is composed of a diverse group of participants, including central banks, commercial banks, investment banks, hedge funds, multinational corporations, and individual traders. Each participant has different motivations and strategies for engaging in the forex market, ranging from hedging against currency fluctuations to speculative trading.

5. Retail Forex Trading

In addition to the institutional participants, the forex market also includes individual or "retail" traders who engage in speculative trading through online trading platforms. Retail forex trading has grown in popularity in recent years, offering individuals the opportunity to participate in the largest financial market in the world.

6. Advantages of Forex Trading

Forex trading offers several advantages, including high liquidity, 24-hour trading, and the ability to leverage positions. Additionally, the forex market is known for its low barriers to entry, making it accessible to a wide range of traders.

7. Risks and Considerations in Forex Trading

While forex trading can be lucrative, it also carries significant risks, including market volatility, leverage, and the potential for significant losses. Traders must carefully consider their risk tolerance and develop a well-structured trading strategy to navigate the complexities of the forex market.

Key points on how to make money trading forex:

1. Forex trading involves speculating on the exchange rate between currencies to try to profit from changes in their relative values. Traders buy one currency (the base currency) and sell another (the quote currency).

2. Currencies are quoted in pairs, like EUR/USD. The first currency is the base currency, the second is the quote currency. The exchange rate represents how much of the quote currency is needed to buy one unit of the base currency.

3. Traders can "go long" by buying the base currency, betting it will rise in value compared to the quote currency. Or they can "go short" by selling the base currency, betting it will fall in value.

4. The "bid" price is what the broker will pay to buy the base currency from the trader. The "ask" price is what the broker will charge the trader to sell the base currency. The difference between bid and ask is the "spread", which is how the broker makes money on the trade.

5. To make money in forex trading, traders aim to buy a currency pair at a lower price and then sell it back at a higher price, profiting from the difference. Managing risk is critical, as forex can be highly volatile.

The key is to thoroughly understand how forex trading works, including currency pairs, long and short positions, and the bid-ask spread, before attempting to trade real money. A solid forex education is essential.

When to Buy or Sell a Currency Pair

Forex trading involves predicting the rise or fall of one currency relative to another. Fundamental analysis helps to make these predictions based on macroeconomic factors like productivity, employment, and trade.

Example Currency Pairs:

1. EUR/USD:

   - Buy: If you believe the U.S. economy will weaken, buy EUR/USD (expect euros to rise against USD).

   - Sell: If you believe the U.S. economy is strong, sell EUR/USD (expect euros to fall against USD).

2. USD/JPY:

   - Buy: If you think the Japanese government will weaken the yen to boost exports, buy USD/JPY (expect USD to rise against JPY).

   - Sell: If Japanese investors are converting USD to yen, sell USD/JPY (expect USD to fall against JPY).

3. GBP/USD:

   - Buy: If the British economy is expected to outperform the U.S., buy GBP/USD (expect GBP to rise against USD).

   - Sell: If the British economy is slowing, sell GBP/USD (expect GBP to fall against USD).

4. USD/CHF:

- Buy: If the Swiss franc is overvalued, buy USD/CHF (expect USD to rise against CHF).

- Sell: If U.S. economic growth is expected to weaken, sell USD/CHF (expect USD to fall against CHF).

Trading in "Lots":

- Micro Lot: 1,000 units

- Mini Lot: 10,000 units

- Standard Lot: 100,000 units

Margin Trading:

- Leverage: Allows large trades with a small deposit. For example, 50:1 leverage means a $2,000 margin can control a $100,000 position.

- Example Trade:

  - Buy 100,000 GBP/USD at 1.5000 with a 2% margin requirement.

  - Margin required: $3,000.

  - Sell at 1.5050; profit: $500.

  - Return on capital: 16.67% in a short period.

Risks of High Leverage:

- High leverage can lead to significant gains or losses.

- Example: With 100:1 leverage, a 100-pip move can wipe out a $1,000 account.

Here's the continuation, formatted in a formal, concise, and well-noted manner:

Rollover in Forex Trading

Rollover Fee:

- Definition: A daily fee paid or earned for positions held open past your broker's cut-off time (usually 5:00 pm ET).

- Avoiding Fees: Close all positions before 5:00 pm ET to avoid rollover fees.

Interest Mechanics:

- Borrowing and Buying: Forex trades involve borrowing one currency to buy another.

- Interest Paid: On the borrowed currency.

- Interest Earned: On the bought currency.

Interest Rate Differential:

- Positive Differential: If the bought currency has a higher interest rate than the borrowed one, you earn interest (e.g., USD/JPY).

- Negative Differential: If the rate is lower, you pay interest.

Broker Variations:

- Rollovers can vary based on factors like account leverage and interbank lending rates.

- Check with your broker for specific details on rollover rates and procedures.

Major Currency Interest Rates:

COUNTRY	CURRENCY	INTEREST RATE
UNITED STATES	USD	5.25-5.5%
EURO ZONE	EUR	4.25%
UNITED KINGDOM	GBP	5.25%
JAPAN	JPY	0-0.10%
CANADA	CAD	4.75%
AUSTRALIA	AUD	4.35%
NEW ZEALAND	NZD	5.5%
SWITZERLAND	CHF	1.50%

These rates are set by central banks for lending short-term money to commercial banks.

PIP, LOT AND SPREAD

Pip:

Definition: A pip (short for "percentage in point" or "price interest point") is the smallest price move that a given exchange rate can make based on market convention. It is typically the fourth decimal place in most currency pairs (e.g., 0.0001).

Example:

- If the EUR/USD moves from 1.1000 to 1.1001, it has moved 1 pip.

- For currency pairs involving the Japanese yen (JPY), a pip is usually the second decimal place (e.g., 0.01).

Lot:

Definition: A lot is a standardized quantity of the currency pair being traded. In forex, there are three main types of lots:

1. Standard Lot: 100,000 units of the base currency.
2. Mini Lot: 10,000 units of the base currency.
3. Micro Lot: 1,000 units of the base currency.

Example:

- If you trade 1 standard lot of EUR/USD, you are trading 100,000 euros.

Spread:

Definition: The spread is the difference between the bid price and the ask price of a currency pair. The bid price is the price at which you can sell the base currency, and the ask price is the price at which you can buy the base currency.

Types of Spreads:

1. Fixed Spread: The spread remains constant regardless of market conditions.
2. Variable (Floating) Spread: The spread changes depending on market volatility and liquidity.

Example:

- If the bid price for EUR/USD is 1.1000 and the ask price is 1.1002, the spread is 2 pips.

KEYPOINTS

- Pip: The smallest price increment in forex trading, usually 0.0001 for most pairs and 0.01 for JPY pairs.

- Lot: The size of the trade, with standard lots (100,000 units), mini lots (10,000 units), and micro lots (1,000 units).

- Spread: The difference between the bid and ask price, representing the transaction cost of trading a currency pair.

Understanding these concepts helps traders make informed decisions, manage risk, and execute trades effectively in the forex market.

Bid Price

Definition: The bid price is the highest price that a buyer (or market participant) is willing to pay for the base currency in a currency pair.

Key Points:

- **Selling Price**: If you want to sell a currency pair, you will do so at the bid price.
- **Market Liquidity**: The bid price reflects the demand for the currency pair. Higher demand typically results in a higher bid price.
- **Displayed First**: In a typical forex quote, the bid price is displayed first (e.g., EUR/USD 1.1000/1.1002, where 1.1000 is the bid price).

Ask Price

Definition: The ask price (also known as the offer price) is the lowest price that a seller (or market participant) is willing to accept for the base currency in a currency pair.

Key Points:

- **Buying Price**: If you want to buy a currency pair, you will do so at the ask price.
- **Market Supply**: The ask price reflects the supply of the currency pair. Higher supply typically results in a lower ask price.
- **Displayed Second**: In a typical forex quote, the ask price is displayed second (e.g., EUR/USD 1.1000/1.1002, where 1.1002 is the ask price).

Bid-Ask Spread

Definition: The spread is the difference between the bid and ask prices. It represents the transaction cost of trading a currency pair.

Example:

- For a EUR/USD quote of 1.1000/1.1002:
    - **Bid Price**: 1.1000
    - **Ask Price**: 1.1002
    - **Spread**: 0.0002 (or 2 pips)

Practical Example

Imagine you are looking at the EUR/USD currency pair with the following quote: 1.1000/1.1002.

1. **Selling (Bid Price)**:
    - If you want to sell EUR/USD, you would do so at the bid price of 1.1000.
    - This means you can sell 1 euro for 1.1000 US dollars.
2. **Buying (Ask Price)**:
    - If you want to buy EUR/USD, you would do so at the ask price of 1.1002.
    - This means you can buy 1 euro for 1.1002 US dollars.

FOREX ORDER TYPES

In the forex market, various types of orders can be used to execute trades. Some of the most common types:

1. Market Order

   - A market order is an instruction to buy or sell a currency pair immediately at the current market price. This type of order guarantees execution but not the price.

2. Limit Order

   - A limit order is an instruction to buy or sell a currency pair at a specified price or better. A buy limit order will execute at the limit price or lower, while a sell limit order will execute at the limit price or higher.

3. Stop Order (Stop-Loss Order)

   - A stop order is an instruction to buy or sell a currency pair when it reaches a specified price. Once the stop price is reached, the stop order becomes a market order. A stop-loss order is commonly used to limit potential losses.

4. Stop-Limit Order

   - A stop-limit order combines the features of a stop order and a limit order. Once the stop price is reached, the order becomes a limit order instead of a market order. This means the trade will only be executed at the specified limit price or better.

5. Trailing Stop Order

   - A trailing stop order is a stop order that "trails" the market price by a specified amount. It automatically adjusts as the market price moves in your favor, helping to lock in profits while limiting losses.

6. Good 'Til Canceled (GTC) Order

- A GTC order remains active in the market until you decide to cancel it. It does not expire at the end of the trading day.

7. Day Order

- A day order is an order that is valid only for the trading day on which it is placed. If it is not executed by the end of the trading day, it is automatically canceled.

8. Fill or Kill (FOK) Order

- A FOK order is an instruction to execute a transaction immediately and completely at the specified price, or else the order is canceled. It does not allow partial fills.

9. Immediate or Cancel (IOC) Order

- An IOC order is an instruction to execute any part of the order immediately at the specified price. Any portion of the order that cannot be filled immediately is canceled.

10. One-Cancels-the-Other (OCO) Order

- An OCO order combines two orders, where the execution of one automatically cancels the other. This is useful for placing both a stop-loss and a take-profit order.

11. One-Triggers-the-Other (OTO) Order

- An OTO order is a contingent order where one order triggers the placement of another order. This is useful for creating complex trading strategies.