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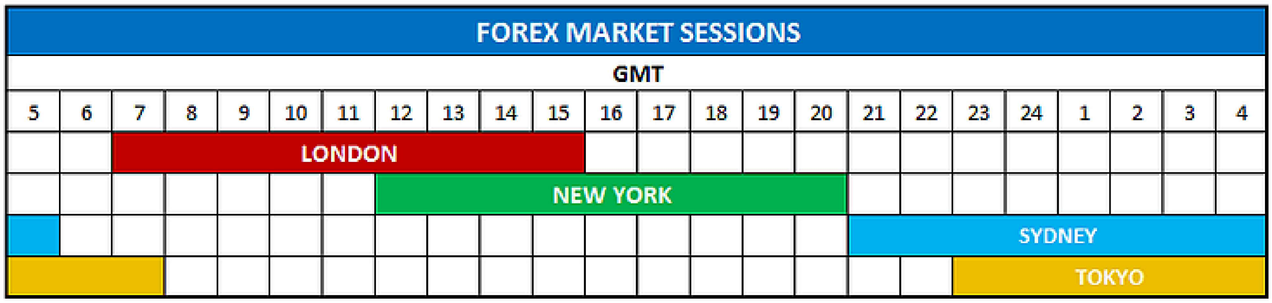
An Introduction to Forex Trading

WHAT IS FOREX?

"FOREX" is an abbreviation of foreign exchange. It's global market that allows the exchange of one currency for another and is also the largest financial market in the world. Compared to New York Stock Exchange (NYSE) which trades a volume of about $22.4 billion each day, the Forex market trades a whooping $6.6 trillion per day.

The foreign exchange market has a number of participants including; Governments & Major banks, large commercial companies, medium-sized & small banks, Hedge funds

The Forex market is open **24 hours a day** and **5 days a week**, only closing down during the weekend. The day starts when traders wake up in Sydney then moves to Tokyo, London, Frankfurt and finally, New York, before trading starts all over again in Sydney!



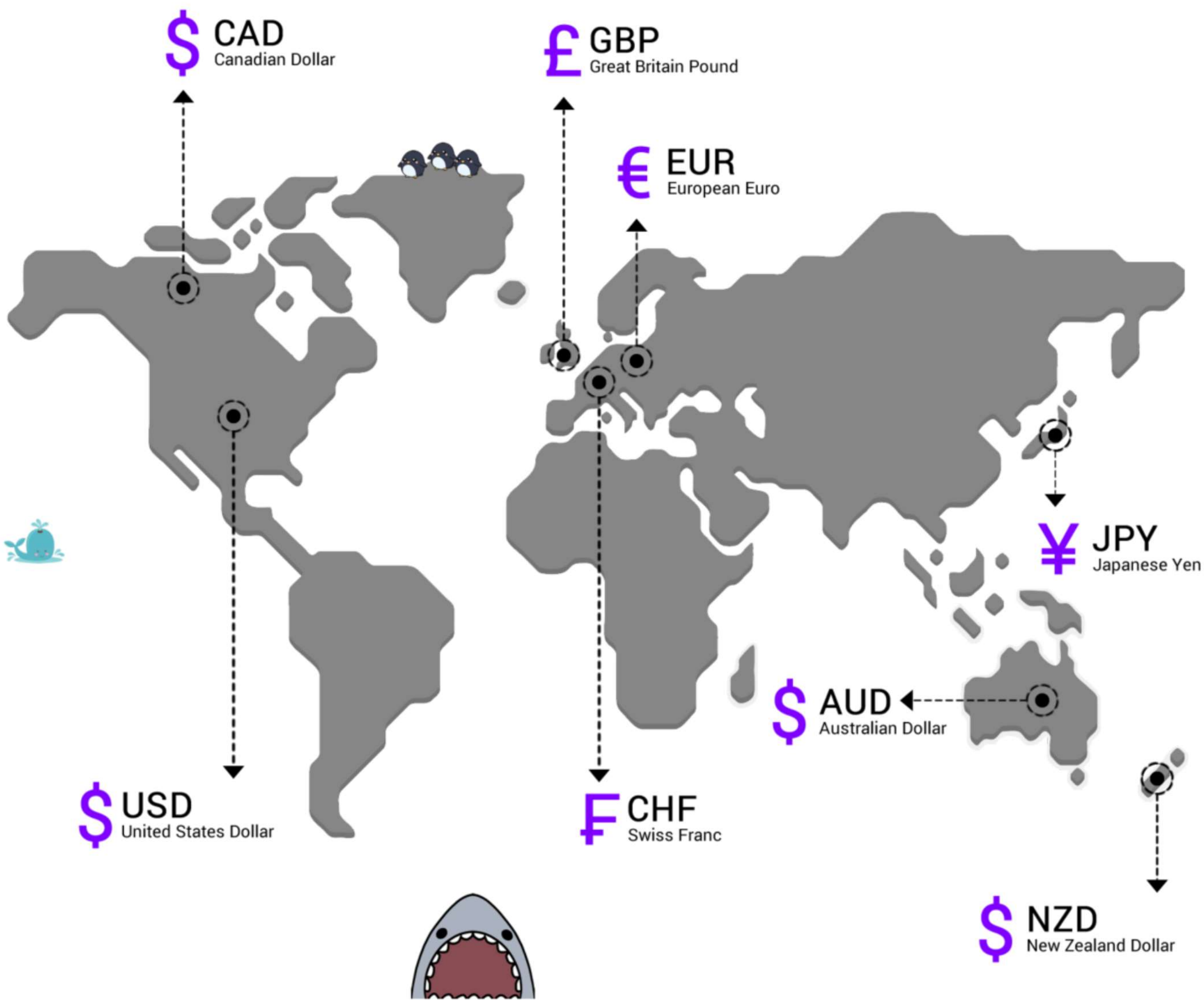
GMT trading hours

So, what exactly is being traded?

The simple answer is **MONEY**.

Think of buying a currency as buying a share in a particular country, kinda like buying stocks of a company. The price of the currency is usually a direct reflection of the market's opinion on the current and future health of its respective economy.In Forex trading, when you buy, say, the Japanese yen, you are basically buying a "share" in the Japanese economy.You are *betting* that the Japanese economy is doing well, and will even get better as time goes. Once you sell those "shares" back to the market, hopefully, you will end up with a profit.

Currency Pairs



Major currency pairs:

These are pairs that cross with the Dollar (USD). They include, EURUSD, GBPUSD, AUDUSD, NZDUSD, USDJPY, USDCAD.

Minor currency pairs:

When a currency pair doesn't include the US dollar, it's called a minor currency pair or a cross-currency pair.

Exotic currency pairs: An exotic currency pair includes a major currency and the currency of a developing economy (such as Brazil or South Africa). You won't find exotic pairs as often as you'll find major or minor pairs, which means the spreads can be higher when trading them.

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Buying and Selling Currency Pairs

Forex trading is the simultaneous buying of one currency and selling another. Currencies are traded through a broker or dealer, and are traded in pairs.

For example the euro and the U.S. dollar (EUR/USD) or the British pound and the Japanese yen (GBP/JPY).

When you trade in the Forex market, you buy or sell in currency pairs. Imagine each currency pair constantly in a "tug of war" with each currency on its own side of the rope. Exchange rates fluctuate based on which currency is stronger at the moment.

Different Ways to Trade Forex

There are a number a of different ways to invest or speculate in currencies. The most popular ones are **spot Forex**, currency **futures**, currency **options** and currency **exchange-traded funds**(ETFs).

Currency Futures: Futures are contracts to buy or sell a certain asset at a specified price on a future date. Since futures contracts are standardized and traded on a centralized exchange, the market is very transparent and well-regulated. This means that price and transaction information are readily available.

Currency Options: An "option" is a financial instrument that gives the buyer the right or the option, but not the obligation, to buy or sell an asset at a specified price on the option's

Currency ETFs: Exchange-traded funds or ETFs are the youngest members of the Forex world. ETFs are created and managed by financial institutions who buy and hold currencies in a fund. They then offer shares of the fund to the public on an exchange allowing you to buy and trade these shares just like stocks.

Spot Forex Market: In the spot market, currencies are traded immediately or "on the spot," using the current market price. What's awesome about this market is its simplicity, liquidity, tight spreads, and round-the-clock operations. It's very easy to participate in this market since accounts can be opened with as little as $50!

How To Invest In Forex

Forex Brokers

Back in the 90s, it was much more difficult to participate in the retail FX market because of higher transactions costs. Nowadays, the internet has made it much easier open an account with an online forex broker and invest.

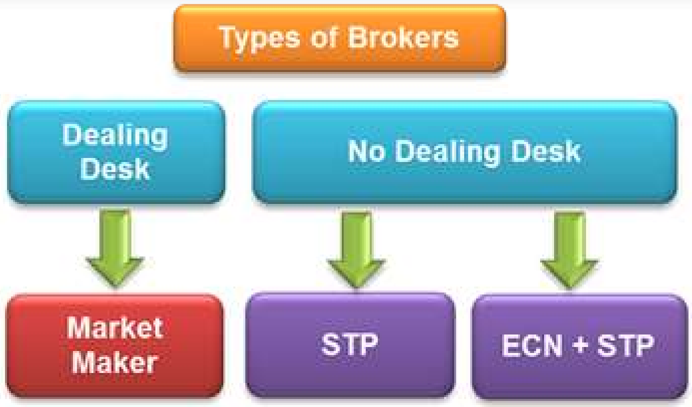
There are two types of forex brokers:

1. **Dealing Desks (DD)**
2. **No Dealing Desks (NDD)**.

Dealing Desk brokers are also called **Market Makers**.

No Dealing Desks can be further subdivided into:

- *Straight Through Processing (STP) and*
- *Electronic Communication Network + Straight Through Processing (ECN+STP)*.



What is a Dealing Desk Broker?

Forex brokers that operate through Dealing Desk (DD) brokers make money through spreads and providing liquidity to their clients. Also called "market makers,"

Dealing Desk brokers literally create a market for their clients, meaning they often take the other side of a clients trade.
While you may think that there is a conflict of interest, there really isn't.

Market makers provide both a sell and buy quote, which means that they are filling both buy and sell orders of their clients; they are indifferent to the decisions of an individual trader.

Let's say you place a buy order for EUR/USD for 100,000 units with your Dealing Desk broker.

To fill you, your broker will first try to find a matching sell order from its other clients or pass your trades on to its liquidity provider, i.e. a sizable entity that readily buys or sells a financial asset.

By doing this, they minimize risk, as they earn from the spread without taking the opposite side of your trade.
However, in the event that there are no matching orders, they will have to take the opposite side of your trade.

What is a 'No Dealing Desk Broker' ?

As the name suggests, No Dealing Desk (NDD) brokers do NOT pass their clients' orders through a Dealing Desk.

This means that they do not take the other side of their clients' trade as they simply link two parties together.

NDDs are like bridge builders: they build a structure over an otherwise impassable or hard-to-pass terrain to connect two areas.

NDDs can either charge a very small commission for trading or just put a markup by increasing the spread slightly.

No Dealing Desk brokers can either be **STP or STP+ECN.**

ECN BROKERS

An ECN broker is a forex financial expert that uses electronic communications networks (ECNs) to give clients direct access to other participants in currency markets.

Because an ECN broker consolidates price quotations from several market participants, it can generally offer its clients tighter bid/ask spreads than would be otherwise available to them.

True ECN forex brokers, allow the orders of their clients to interact with the orders of other participants in the ECN.

ECNs also allow their clients to see the **"Depth of Market."**

Depth of Market displays where the buy and sell orders of other market participants are.

Because of the nature ECN, it is very difficult to slap on a fixed markup so ECN brokers usually get compensated through a small **COMMISSION.**

What is an STP Broker?

Some brokers claim that they are true ECN brokers, but in reality, they merely have a **Straight Through Processing** system.

Forex brokers that have an STP system route the orders of their clients directly to their liquidity providers who have access to the inter-bank market.

NDD STP brokers usually have many liquidity providers, with each provider quoting its own bid and ask price.

This changing bid/ask quote is the reason why most STP type brokers have variable spreads. If the spreads of their liquidity providers widen, they have no choice but to widen their spreads too.

Some STP brokers do offer fixed spreads, but most have **VARIABLE** spreads.