Title:
Understanding Forex - #1 - What is Forex?

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Summary:
This is a series of articles about The Foreign Exchange Market. You will learn here what Forex is , how it works and how profitable it can be. The whole series contain the following articles . . .

Keywords:
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Article Body:
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1. What is Forex

2. Technical analysis

3. Fundamental analysis

4. Money management

5. Compound interest

What is Forex?

The word Forex is an acronym for The Forex Exchange Market. This is the most liquid market on the world where you can trade or exchange one currency for another. For example, if you think that the Euro will appreciate in value and you have US dollars, you can trade the dollars for the Euros. If you are right and the Euro appreciates in value in relationship with the dollars, then you can close the position realizing a profit.

That’s the basic idea behind the Spot Forex Market. This is an interbank system which means that it is not centralized. There is no central exchange where currencies are traded. It is a global market. You can trade Forex online

24 hours per day, 6 days per week.

This market emerged at the beginning of the 70's decade. The reason was that currencies where not backed up by gold anymore. They began floating freely. Their value depended on forces of supply and demand due to economic factors, speculation, etc. This originated the Forex Market.

You can trade Forex on the Internet as I said above. There are many brokers like www.oanda.com that allow you to open an account with just $300 to $500 and start trading online. You can also get a demo account first and trade with play money just to “test the waters” and see if you like this market or not.

Demo accounts are free with most brokers. Some brokers offer demo accounts which expire within 30 days while others never expire. It is important to trade on paper, because you can test your strategies and see if they work or not.

Trading Forex is risky, but it can be very profitable too. You can trade at anywhere from 20: 1 to 400: 1 leverage. This means that the broker will lend you more money than you have on the account to trade.

For example, let’s say that a broker allows you to trade at 100: 1 leverage. If you use all the leverage, for every dollar that you have on the account you can trade 100. Let’s say that you have $1,000. With $1,000 at 100: 1 you can trade $100,000 worth of dollars in exchange for other currencies. You multiply your trading potential a lot. This allows you to realize bigger profits, but you also incur in bigger risks.

Let me show you an example. Let’s say that you have 100: 1 leverage on the account and you trade at full leverage with $1,000. The EUR/USD pair (Euro/US Dollar) is trading at 1.2500. So, you enter a position on this pair.

Let’s say that you are long. If the market moves in your favor by just one cent (1.2600), you will double your money and end up with $2,000 on the account. If the market moves against you by just one cent (1.2400), you will lose all the money that you have on the account or most of it depending on the broker you are trading with.

This can happens really quick. The market can move this much in a matter of minutes or hours. This is what makes Forex very profitable, but also very volatile. I don’t know if novice traders can understand the magnitude of what I am saying here. Many people get into Forex trading only seeing half of the truth. They get pulled into this market by all the hype flying around it.

I do believe that no other market in the world offer the opportunity to make money like this market does. On the other hand, there are some risks involved. It is important for new traders to trade on paper first before compromising real capital. We learn doing. I didn’t learn many basic concepts about this market until I started trading with a demo account.

Now, let me explain other important facts. The Spot Forex Market is traded in currency pairs. Whenever you enter a position you trade one currency for another. For example if you buy EUR/USD you are buying Euros and selling US Dollars. If you sell EUR/USD you are selling Euros and buying US Dollars.

When you enter a position, you can not trade other currency pairs unless you have additional funds on your account, but you can trade several currency pairs at the same time as long as you have enough margin/funds to trade. If you have never traded Forex before, you can see how all this works when you practice with a demo account.

Another thing that you would like to know is that Forex is traded in pips. Your profit on every trade depends on many aspects. One of those aspects are pips. Another one is how much leverage you are using per trade. A pip is the minimum unit that the price of a currency pair can move.

For example, in the case of the EUR/USD a pip is equal to 0.0001. If the price is at 1.2500 and it moves to 1.2501, it moved one pip. If it moves from 1.2500 to 1.2600 it moves 100 pips, like in the example above.

Now, how much you make on every trade depends on how many pips you make and how much money you invested on that trade. Also, what is the leverage for that account. If you trade at full leverage with a 100: 1 leverage account and you trade $1,000, if the market moves 50 pips in your favor, then you will make $500. This can happen within just a few minutes after you enter your order.

Most experienced traders wouldn’t recommend you to trade this way though. The reason is that if the market moves against you, then you could lose everything within minutes. It is better to have lower profit goals for every single trade and compound your profits over time.

Money management principles stay that it is better to never risk more than 1% - 3% of your capital, specially if you are an inexperienced trader. This is something that I will explain more under other article of this series.

Well, I hope this information have been helpful to you. This was an introduction to the Forex Market. You can read more about Forex on my other articles.