

# FOREX FOR BEGINNERS

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## I. Introduction

Foreign Exchange (Forex) trading is considered as one of the most financially rewarding professions ever to exist. Being good at it takes time and energy but it nevertheless happens. There are many ways to learn the trick of this trade. One of the most comprehensive means, not to mention cheapest, is by learning from the various forex tutorials and forex e-books being offered for free via the Internet. This particular e-book aims to give a beginner a glimpse of the basic things he needs to know about foreign exchange trading.

Forex education cannot be incorporated in any single book. Not only is it very broad, it cannot be explained through words alone. Basic education that can be studied through books, word-of-mouth advices from experienced traders, and continuous learning as experienced by the new trader himself will make up a truly comprehensive forex education. Even long years of experience shouldn't stop a trader from still learning something new from the business.

Forex education is best treated like a school course. Level by level, the beginner will slowly learn and understand the forex trading business and everything else that affects it or it affects. It would be wise to take the education in divisions, like that of a student. There will be information to be learned on the pre-school level, elementary level, middle school level, high school level and the college level. These several numbers of levels are not surprising since the subject of foreign exchange market is such a broad matter that it could not be summarized in a single manual or pamphlet.

In fact, this e-book will only be discussing the very basic data that a beginner should know. It will actually be presenting only the pre-school level of forex education. Although not all the things that a newcomer in forex trading need to learn will be found in this e-book, it is however necessary to learn the basics to serve as the foundation for the more complex information that a new trader will later learn regarding forex trading. After learning the basics by heart, the beginner is now equipped with ample, although still far from enough, knowledge, that would enable him to proceed to learn and understand further information about forex trading.

## II. Forex and Forex Basics

The largest financial market in the world, having an enormous volume of more than 4 billion dollars daily, is the Foreign Exchange Market. This is also referred to as Forex, FX, Retail Forex, Spot FX or simply Spot. The forex is currently the world's biggest financial market with no less than \$4,000,000,000,000 (4 trillion) traded daily. If you will add the amounts traded in the stock market and the futures market and multiply the result by three, you will still be trading less than what is traded in the foreign exchange. That is how big the forex market is compared to others.

Money is what is traded on the Foreign Exchange Market. Forex trading is buying one currency and at the same time selling another currency. Trading is done through a dealer or a broker. Currencies are traded in pairs, such as the euro and the US dollar. When you buy a share in a particular country, you are in effect buying a share in that country's economy. The price of the currency of that country is a direct reflection of current and future economic condition. This is why it is very important to compare one economy from another. The exchange rate of one country against another country spells the difference in their economy. Say for example the exchange rate of the US dollar to the Philippine peso, which is \$1 – P49 as of this writing. The rate of the dollar against the peso directly reflects the US economy's advantage over that of the Philippine economy.

The Forex market has neither a physical location nor a central exchange. The forex market is run electronically over a 24-hour period within a network of banks. Hence, it is also called an "over-the-counter" or an "interbank" market. Forex was, at the beginning, intended only for banks and big institutions. You would trade with an initial fifty million dollars, an amount unaffordable by "small timers." Due to the rise of the Internet, "retail" traders are now offered trading accounts by online forex trading firms.

To get started, a "retail" trader needs a computer, a high-speed Internet connection and the information within this site. A spot market deals in the current price of a financial instrument, and the most popular currencies traded are the U.S. dollar (USD), the European members' Euro (EUR), the Japanese Yen (JPY), the Great Britain Pound (GB), the Switzerland Franc (CHF), the Canadian dollar (CAD), the Australian Dollar (AUD) and the New Zealand Dollar (NZD). A nickname is assigned to each currency for shorter referrals. For the dollar, it is Buck, for Euro it is Fiber, yen for Yen, Cable for pound, Swissy for Franc, Loonie for the Canadian dollar, Aussie for the Australian dollar and Kiwi for the New Zealand dollar. A symbol is also assigned to each currency. Each symbol has three capital letters, wherein the 1<sup>st</sup> two letters identify the country and the 3<sup>rd</sup> letter, the name of the currency, for instance, USD for US dollars and JPY for the Japanese yen.

The spot FX market trades currencies 24 hours daily. A financial center is open for business, and banks and other institutions exchange currencies day and night, with only minor gaps during weekends. You can trade at the foreign exchange markets late at night or early in the morning. Each country has their specific time zone. For Tokyo Open, New York time is 7:00 PM and GMT is 0:00. In Tokyo Close, NY time is 4:00 AM and GMT is 9:00. As for London Open and Close, New York time is 3:00 AM and 12:00 PM and GMT is 8:00 and 17:00 respectively. For New York Open, New York time is 8:00 AM and GMT is 13:00. Lastly,

in New York Close, NY time is 5:00 PM and GMT is 22:00.

The Forex OTC (over-the-counter) market is by far the largest and proved to be the most popular worldwide because a large number of individuals and institutions trade in this financial market. Traders decide who to trade with, taking into consideration trading conditions, reputation of the counterpart and price attractiveness. For the currency distribution, dollar is the currency, which is most traded in the Forex market. It takes up to 89% of foreign exchange transactions. Euro comes in second, with a total of 37% while the Japanese Yen covers 20% of the transactions.

Many people trade foreign currencies because of the many benefits and advantages. Firstly, this is a 24-hour market and you can trade any time of the day. There are no commissions. No need to pay any government fees, brokerage fees, exchange fees and clearing fees. Brokers get their compensation for services through “bid-ask spread”.

Forex currency trading does not require middlemen. You can trade directly with the market in charge of pricing specific currency pair. In the future market, the exchanges determine the lot or contract sizes. But in Spot forex, the trader determines his own lot size. The traders with small accounts (say \$250) can still participate. There is no fixed lot size. Under normal market conditions, retail transaction cost (“bid-ask spread”) is low, about less than 0.1%. The spread could be as low as 0.07% at larger dealers, depending on your leverage.

Leverage enables the trader to gain good profits and simultaneously keep risk capital to a minimum level. To illustrate, forex brokers may offer 200 to 1 leverage, meaning a \$50-margin deposit would allow a trader to buy or sell \$10,000-worth of currencies. In the same manner, with 500 dollars, one could trade with \$100,000, and so forth. But it is important to note that this high degree of leverage can result to big losses as well as gains. Proper risk management is noteworthy.

You can relax though. No single entity, not even a central bank, can control the market price for an extended period. The forex market is so big and its participants are numerous. Because of its enormity, the Forex market is also extremely liquid!

Forex brokers offer “mini” and “micro” trading accounts, thus making Forex much more accessible to the average or poorer individuals with little start-up trading capital.

### III. How to Gain Profit from Forex Trading

For those with experience in trading the stocks or futures, forex trading will be easy to understand. It is basically the buying or selling of currencies. The main goal in forex trading is to exchange or buy one currency for another currency, with the expectation that the price of the currency you bought or exchanged will have an increased value compared to the currency you sold or exchanged it with. That is how you make money from forex trading.

To illustrate, let us say for example that you bought 100,000 Euros at the EUR/USD exchange rate of 1.20. Then after a week, you exchange back those 100,000 Euros to dollar, this time at an increased rate of 1.25. EUR100,000 multiplied by 1.20 is US\$120,000 and EUR100,000 multiplied by 1.25 is US\$125,000. The difference between the two is your profit. If millions instead of hundreds of thousands are involved, then bigger profits are earned. Both rates 1.20 and 1.25 are the ratios of one currency over the other. Using the same example, it simply means that 1 euro can purchase 1.2 or 1.25 US dollars. This is just an example and it does not mean that these are the actual and present exchange rates of the two currencies.

You may ask why currencies are always quoted in pairs. This is because in every forex transaction, you buy one currency the very same time that you are selling another. Let us use another illustration, considering the sample "forex quote" we used above, EUR/USD=1.2500. The euro in this equation is called the "base currency." The US dollar on the other hand is the "counter or quote currency." If you will buy a currency given this example, the exchange rate dictates how much you need to pay in units of the quote currency (which is the dollar in this example) to purchase one unit of the base currency (the euro in this case). Therefore, you have to pay 1.25 U.S. dollars to purchase 1 euro. If you will be selling, the same principle applies. Only this time, again using the same example, the exchange rate dictates how many units of the quote currency (dollar) you will get if you will sell one unit of the base currency (euro). This means that you will have 1.25 U.S. dollars for every euro you sell.

The basis for buying and selling in a forex trading market is the "base currency." If you say you will buy EUR/USD, it means you are buying the base currency (euro) and at the same time selling the quote currency (dollar). The base currency is also the basis of the trader's movement in forex. If he thinks the base currency in a pair will go up, then it is a wise move to buy the pair. If, on the other hand, he thinks that the base currency will go down, then it is wise to sell the pair.

In forex trading lingo, two of the most important words to remember are "long" and "short." "Long" and "buy," as well as "short" and "sell" are respective synonyms. When you buy, it is already in your mind and in your expectation that the base currency will rise in value so that you could, in turn, sell it at a higher price. This is what the traders call taking a "long position" or "going long." If selling, you expect the base currency to depreciate so that you could buy it back at a lower price. This now is what is called by traders as a "short position" or going short.

Another set of words to be remembered when trading currencies are the words "bid" and "ask." The dealer's "bid" is actually the price he is willing to pay to buy the base currency

in exchange of the quote currency. It therefore means that the bid is the amount at which you will sell. On the other hand, the “ask” is the dealer’s price at which he will sell the base currency for the quote currency. The “ask” therefore is the amount at which you will buy. The difference between the two is called the “spread.” If you already start forex trading, you will see how user-friendly this bid and ask process is as formatted by the forex trading. All the trader needs to do is click on the icons when he decides to either bid or ask or buy or sell and he is well on his way to the next transaction.

Now one would ask where he/she will base what currencies to buy or sell. Forex trading is not a game of cards wherein a lot is based on luck. Decisions on whether to buy or sell currencies are based largely on what is happening in the economies of the nation where the currency involved came from. It also depends on many factors that have direct or indirect effects on a nation’s economy. It is therefore important to be aware of what is going on and be vigilant of updates and news around the world, or at least of the news about the country whose currency you want to trade with. It is wiser however to generally have a knowledge of what is going on in the world for what happens in one country may have a domino effect and thereby affect other countries. The current recession for example is not limited to certain nations only, but the whole world.

To illustrate again, let us use USD/JPY this time. The base currency in this example is the U.S. dollar and the quote currency is the Japanese yen. The U.S. dollar therefore is the basis for the buy and sell. It is important for the trader to study the current economic situations of these countries to wisely make the move of either buying or selling. If you, as the trader, think that the Japanese yen is going to weaken since the Japanese export industry needs help, then it would be a wise move to execute a BUY USD/JPY order. This means buying the dollars thinking that the value will appreciate over the yen. If, however, your analysis brought you to thinking that the Japanese investors are taking money from the U.S. market and turning the dollars into yen, thereby hurting the U.S. dollar, then you should execute a SELL USD/JPY order. This means selling your dollars expecting that the yen’s value will go down.

For new traders who have a capital that is not too big and want to buy currencies, but do not have enough money, is trading still possible for them? The answer is yes. This could be done via margin trading. Simply put, margin trading is trading with the use of borrowed capital. It is trading on credit. It is through this technique that a trader with as little as \$1,000 can open positions worth \$10,000 to \$100,000. Margin trading is quantified according to “lots” in the forex market. A “lot” is the minimum price of the currency you need to buy. In forex trading, it is not usual to talk retail, as in buying 1 dollar or selling 1 euro. Forex transactions are done in “lots.” To analogize, you do not buy a couple of grapes, you buy them in bunches. We do not usually buy one or two eggs; we buy them by the dozen. That is how you will use a “lot” in forex. Depending on the account you have, a lot is 10,000 for a mini account and 100,000 for a standard account.

To put the above ideas in actual instance, let us say your observation and analysis brings you to think that the Euro will further go up against the U.S. dollar and you want to buy Euros in exchange for U.S. dollars, expecting the former to appreciate. You may elect to open a lot (100,000) and buy the Euros with it at a margin of 1%. If the exchange rate for EUR/USD is 1.25, you will in effect be buying 100,000 Euros at a price of 125,000 U.S. dollars. Since the margin is 1%, then the amount to be set aside in your account is 1% of

125,000, which is US\$1,250. This means that your \$US1,250 made you in control of 100,000 Euros. If your analysis is correct and the euro appreciated over the dollar, let us say, to 1.2550, then you will have earned 50 pips or \$500. A pip is the tiniest price movement in a currency and more about this will be discussed in the next chapter. Should you decide to close the position, the deposit you previously made will go back to you and profits or losses you made will be credited to your account after calculations.

It is worthy to note that positions that are still open by the broker's cut-off time equate to a rollover interest, which the trader will either pay or earn depending on his position. A borrowed currency would entail the trader to pay interest and a bought currency earns a trader interest. The cut-off time is usually at 5:00pm, Eastern Saving Time (EST). It would be better to close the account before the end of the trading day in order for the trader not to earn or pay interests. Your broker/dealer may be able to give you the specific details you need to know regarding rollover. Many brokers adjust their rates (rollover rates) depending on factors such as lending rates and account leverage. It would also be helpful for you to know that each currency is designated its own rate. U.S. dollar rate is .25%, Euros are 2%, Australian dollars are 4.25%, Japanese Yen are 0.10%, Swiss Francs are 0.5%, Canadian dollars are 1%, New Zealand dollars are 5% and the British Pounds are 1.5%.

It is highly advisable that traders do not go into trading with real money immediately. They may do some practicing by opening a demo account first before delving into the real world of forex. This demo account is free and allows the new trader to gain the full capabilities of a real account. Brokers offer these demo accounts for free to lure them to love the trade and eventually open a real account with them. It favors the brokers in terms of advertisement but it also favors the new trader since he manages to learn the ins and outs of forex trading without the actual risk. Any forex trading expert would advise a new trader to make use of these demo accounts before the real thing.