



Introduction To Foreign Exchange

A Little History

The purpose of this ebook is to introduce the forex market to you. As with many markets there are many derivative of the central market such as futures, options and forwards. For the purpose of this book we will only be discussing the main market sometime referred to as the Spot or Cash market.

Before we begin, let's review what is now being called the "Perfect" trading platform.

eToro Review

About Forex

The Forex market has quickly become the world's largest financial market, with an estimate daily turnover of \$3.2 trillion. It is a market that has great appeal to a financial trader because of its volume which guarantees liquidity. High liquidity means that a trader can trade whatever currencies he feels like at all times, since there will always be someone to buy and sell any currency he wants. Another outstanding feature of the forex market is that it is active 24 hours a day and is closed only on the weekends. This means that unlike the stock market for example,

traders in the forex market don't need to wait for a bell to ring, but can make trading decisions around the clock.

Enter the internet into the equation. Now the forex market is literally at your fingertips. Most brokers offer online trading facilities which enable you to trade simply by clicking a button, instead of the traditional phone call. The internet has really revolutionized the industry, making the retail section of the market more dominant than ever.

About eToro

eToro is a forex trading platform developed to cater to the emerging retail segment of the forex market. With its simple style and exciting trade visualizations, eToro is the perfect platform for a novice trader to get his first forex trading experience. With its great array of professional forex trading and analysis tools, eToro is also the perfect platform for experts in the field who want to trade comfortably and reliably. eToro has developed a truly intuitive interface that lets traders concentrate on trading instead of messing around with bulky and overcomplicated software.

It's important to mention that eToro also offers an educational experience, so novices can gain knowledge of the forex market and eventually become pros if they're so inclined. eToro offers forex trading guides, forums and video tutorials to facilitate their traders' progress. eToro also offers an unlimited practice mode where both beginner and seasoned traders can sharpen their skills and test their strategies with real market rates.

Overall eToro have successfully designed a software that caters to a very wide segment of the forex trading public. eToro is bound to remain a leader in the forex industry for a long time to come.

eToro's features:

Visual representation of trades: Monitor your trades with ease by watching creative visualizations of your trading activity.

Practice mode: Test your skills and strategies by trading with live rates, without risking a cent.

Trading Challenges: Compete against fellow traders for cash prizes - with no entry fees.

Trade: Enjoy immediate and accurate execution with all your trades.

Low Spreads: Save a fortune on eToro's super low spreads - as low as 2 pips.

And soon to come:

Trade: Enjoy real time execution with all your trades.

eToro's Pro Insight: Get a look at what currency pairs eToro's top 100 traders are trading at the moment, and use the inside info to your advantage!

Download eToro for **FREE** and join a fast growing forex community.

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What's Different?

Unlike many other securities (any financial instrument that can be traded) the FX market does not have a fixed exchange. It is primarily traded through banks, brokers, dealers, financial institutions and private individuals. Trades are executed through phone and increasingly through the Internet. It is only in the last few years that the smaller investor has been able to gain access to this market. Previously the large amounts of deposits required precluded the smaller investors. With the advent of the Internet and growing competition it is now easily in the reach of most investors.

You will often hear the term INTERBANK discussed in FX terminology. This originally, as the name implies was simply banks and large institutions exchanging

information about the current rate at which their clients or themselves were prepared to buy or sell a currency. **INTER** meaning between and **Bank** meaning deposit taking institutions normally made up of banks, large institution, brokers or even the government. The market has moved on to such a degree now that the term **interbank** now means anybody who is prepared to buy or sell a currency. It could be two individuals or your local travel agent offering to exchange Euros for US Dollars. You will however find that most of the brokers and banks use centralized feeds to insure reliability of quote. The quotes for **Bid (buy)** and **Offer (sell)** will all be from reliable sources. These quotes are normally made up of the top 300 or so large institutions. This insures that if they place an order on your behalf that the institutions they have placed the order with is capable of fulfilling the order.

Now although we have spoken about orders being fulfilled, it is estimated that anywhere from **70%-90%** of the **FX** market is speculative. In other words the person or institution that bought or sold the currency has no intention of actually taking delivery of the currency. Instead they were solely speculating on the movement of that particular currency.

Source: Bank For International Settlements <http://www.bis.org> Extract From The Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity.

Currency	1989	1992	1995	1998	2001
US Dollar	90	82.0	83.3	87.3	90.4
Euro	37.6
Japanese Yen	27	23.4	24.1	20.2	22.7
Pound Sterling	15	13.6	9.4	11.0	13.2
Swiss Franc	10	8.4	7.3	7.1	6.1

As you can see from the above table over **90%** of all currencies are traded against the **US Dollar**. The four next most traded currencies are the **Euro (EUR)**, **Japanese Yen (JPY)**, **Pound Sterling (GBP)** and **Swiss Franc(CHF)**. As currencies are traded in pairs and exchanged one for the other when traded, the rate at which they are exchanged is called the **exchange rate**. These four currencies traded against the **US Dollar** make up the majority of the market and are called **major currencies** or the **majors**.

Market Mechanics

So now we know that the FX market is the largest in the world and that your broker or institution that you are trading with is collecting quotes from a centralized feed or individual quotes comprising of interbank rates. So how are these quotes made up. Well, as we previously mentioned currencies are traded in pairs and are each assigned a symbol. For the Japanese Yen it is JPY, for the Pounds Sterling it is GBP, for Euro it is EUR and for the Swiss Franc it is CHF. So, EUR/USD would be Euro-Dollar pair. GBP/USD would be pounds Sterling-Dollar pair and USD/CHF would be Dollar-Swiss Franc pair and so on. You will always see the USD quoted first with few exceptions such as Pounds Sterling, EuroDollar, Australia Dollar and New Zealand Dollar. The first currency quoted is called the base currency. Have a look below for some example.

Currency Symbol Currency Pair

EUR/USD	Euro / US Dollar
GBP/USD	Pounds Sterling/ US Dollar
USD/JPY	US Dollar / Japanese Yen
USD/CHF	US Dollar / Swiss Franc
USD/CAD	US Dollar / Canadian Dollar
AUD/USD	Australian Dollar / US Dollar
NZD/USD	New Zealand Dollar / US Dollar

When you see FX quotes you will actually see two numbers. The first number is called the bid and the second number is called the offer (sometimes called the ASK). If we use the EUR/USD as an example you might see 0.9950/0.9955 the first number 0.9950 is the bid price and is the price traders are prepared to buy Euros against the USD Dollar. The second number 0.9955 is the offer price and is the price traders are prepared to sell the Euro against the US Dollar. These quotes are sometimes abbreviated to the last two digits of the currency such as 50/55. Each broker has its own convention and some will quote the full number and others will show only the last two. You will also notice that there is a difference between the bid and the offer price and that is called the spread. For the four major currencies the spread is normally 5 give or take a pip (will explain pips later)

To carry on from the symbol conventions and using our previous EUR quote of 0.9950 bid, that means that 1 Euro = 0.9950 US Dollars. In another example if we used the USD/CAD 1.4500 that would mean that 1 US Dollar = 1.4500 Canadian Dollars.

The most common increment of currencies is the PIP. If the EUR/USD moves from 0.9550 to 0.9551 that is one Pip. A pip is the last decimal place of a quotation. The

Pip or POINT as it is sometimes referred to depending on context is how we will measure our profit or loss.

As each currency has its own value it is necessary to calculate the value of a pip for that particular currency. We also want a constant so we will assume that we want to convert everything to US Dollars. In currencies where the US Dollar is quoted first the calculation would be as follows.

Example JPY rate of 116.73 (notice the JPY only goes to two decimal places, most of the other currencies have four decimal places)

In the case of the JPY 1 pip would be .01 therefore

USD/JPY: (.01 divided by exchange rate = pip value) so $.01/116.73=0.0000856$ it looks like a big number but later we will discuss lot (contract) size.

USD/CHF: (.0001 divided by exchange rate = pip value) so $.0001/1.4840 = 0.0000673$

USD/CAD: (.0001 divided by exchange rate = pip value) so $.0001/1.5223 = 0.0001522$

In the case where the US Dollar is not quoted first and we want to get to the US Dollar value we have to add one more step.

EUR/USD: (0.0001 divided by exchange rate = pip value) so $.0001/0.9887 = \text{EUR } 0.0001011$ but we want to get back to US Dollars so we add another little calculation which is $\text{EUR} \times \text{Exchange rate}$ so $0.0001011 \times 0.9887 = 0.0000999$ when rounded up it would be 0.0001.

GBP/USD: (0.0001 divided by exchange rate = pip value) so $0.0001/1.5506 = \text{GBP } 0.0000644$ but we want to get back to US Dollars so we add another little calculation which is $\text{GBP} \times \text{Exchange rate}$ so $0.0000644 \times 1.5506 = 0.0000998$ when rounded up it would be 0.0001.

By this time you might be rolling your eyes back and thinking do I really need to work all this out and the answer is no. Nearly all the brokers you will deal with will work all this out for you. They may have slightly different conventions but it is all done automatically. It is good however for you to know how they work it out. In the next section we will be discussing how these seemingly insignificant amounts can add up.

More On Market Mechanics

Spot Forex is traditionally traded in lots also referred to as contracts. The standard size for a lot is \$100,000. In the last few years a mini lot size has been introduced of \$10,000 and this again may change in the years to come. As we mentioned on the previous page currencies are measured in pips, which is the smallest increment of that currency. To take advantage of these tiny increments it is desirable to trade large amounts of a particular currency in order to see any significant profit or loss. We shall cover leverage later but for the time being let's assume we will be using \$100,000 lot size. We will now recalculate some examples to see how it effects the pip value.

USD/JPY at an exchange rate of 116.73

$$(.01/116.73) \times \$100,000 = \$8.56 \text{ per pip}$$

USD/CHF at an exchange rate of 1.4840

$$(0.0001/1.4840) \times \$100,000 = \$6.73 \text{ per pip}$$

In cases where the US Dollar is not quoted first the formula is slightly different.

EUR/USD at an exchange rate of 0.9887

$(0.0001/0.9887) \times \text{EUR } 100,000 = \text{EUR } 10.11$ to get back to US Dollars we add a further step

$\text{EUR } 10.11 \times \text{Exchange rate}$ which looks like $\text{EUR } 10.11 \times 0.9887 = \9.9957 rounded up will be \$10 per pip.

GBP/USD at an exchange rate of 1.5506

$(0.0001/1.5506) \times \text{GBP } 100,000 = \text{GBP } 6.44$ to get back to US Dollars we add a further step

$\text{GBP } 6.44 \times \text{Exchange rate}$ which looks like $\text{GBP } 6.44 \times 1.5506 = \9.9858864 rounded up will be \$10 per pip.

As we said earlier your broker may have a different convention for calculating pip value relative to lot size but however they do it they will be able to tell you what the pip value for the currency you are trading is at that particular time. Remember that as the market moves so will the pip value depending on what currency you trade.

So now we know how to calculate pip value let's have a look at how you work out your profit or loss. Let's assume you want to buy US Dollars and Sell Japanese Yen. The rate you are quoted is 116.70/116.75 because you are buying the US you will be working on the 116.75, the rate at which traders are prepared to sell. So you buy 1 lot of \$100,000 at 116.75. A few hours later the price moves to 116.95 and you decide to close your trade. You ask for a new quote and are quoted 116.95/117.00 as you are now closing your trade and you initially bought to enter the trade you now sell in order to close the trade and you take 116.95 the price traders are prepared to buy at. The difference between 116.75 and 116.95 is .20 or 20 pips. Using our formula from before, we now have $(.01/116.95) \times \$100,000 = \8.55 per pip $\times 20$ pips = \$171

In the case of the EUR/USD you decide to sell the EUR and are quoted 0.9885/0.9890 you take 0.9885. Now don't get confused here. Remember you are now selling and you need a buyer. The buyer is bidding 0.9885 and that is what you take. A few hours later the EUR moves to 0.9805 and you ask for a quote. You are quoted 0.9805/0.9810 and you take 0.9810. You originally sold EUR to open the trade and now to close the trade you must buy back your position. In order to buy back your position you take the price traders are prepared to sell at which is 0.9810. The difference between 0.9810 and 0.9885 is 0.0075 or 75 pips. Using the formula from before, we now have $(.0001/0.9810) \times \text{EUR } 100,000 = \text{EUR } 10.19$: $\text{EUR } 10.19 \times \text{Exchange rate } 0.9810 = \$9.99 (\$10)$ so $75 \times \$10 = \750 .

To reiterate what has gone before, when you enter or exit a trade at some point you are subject to the spread in the bid/offer quote. As a rule of thumb when you buy a currency you will use the offer price and when you sell you will use the bid price. So when you buy a currency you pay the spread as you enter the trade but not as you exit and when you sell a currency you pay no spread when you enter but only when you exit.

Leverage

Leverage financed with credit, such as that purchased on a margin account is very common in Forex. A margined account is a leverageable account in which Forex can be purchased for a combination of cash or collateral depending what your brokers will accept. The loan(leverage) in the margined account is collateralized by your initial margin (deposit), if the value of the trade (position) drops sufficiently, the broker will ask you to either put in more cash, or sell a portion of your position or even close your position. Margin rules may be regulated in some countries, but margin requirements and interest vary among broker/dealers so always check with the company you are dealing with to ensure you understand their policy.

Up until this point you are probably wondering how a small investor can trade such large amounts of money (positions). The amount of leverage you use will depend on your broker and what you feel comfortable with. There was a time when it was difficult to find companies prepared to offer margined accounts but nowadays you can get leverage from a high as 1% with some brokerages. This means you could control \$100,000 with only \$1,000.

Typically the broker will have a minimum account size also known as account margin or initial margin e.g. \$10,000. Once you have deposited your money you will then be able to trade. The broker will also stipulate how much they require per position (lot) traded. In the example above for every \$1,000 you have you can take a lot of \$100,000 so if you have \$5,000 they may allow you to trade up to \$500,000 of forex.

The minimum security (Margin) for each lot will vary from broker to broker. In the example above the broker required a one percent margin. This means that for every \$100,000 traded the broker wanted \$1,000 as security on the position. Margin call is also something that you will have to be aware of. If for any reason the broker thinks that your position is in danger e.g. you have a position of \$100,000 with a margin of one percent (\$1,000) and your losses are approaching your margin (\$1,000). He will call you and either ask you to deposit more money, or close your position to limit your risk and his risk. If you are going to trade on a margin account it is imperative that you talk with your broker first to find out what their policies are on this type of accounts.

Variation Margin is also very important. Variation margin is the amount of profit or loss your account is showing on open positions. Let's say you have just deposited \$10,000 with your broker. You take 5 lots of USD/JPY which is \$500,000. To secure this the broker needs \$5,000 (1%). The trade goes bad and your losses equal \$5001, your broker may do a margin call. The reason he may do a margin call is that even

though you still have \$4,999 in your account the broker needs that as security and allowing you to use it could endanger yourself and him. Another way to look at it is this, if you have an account of \$10,000 and you have a 1 lot (\$100,000) position. That's \$1,000 assuming a (1% margin) is no longer available for you to trade. The money still belongs to you but for the time you are margined the broker needs that as security. Another point of note is that some brokers may require a higher margin at the weekeneds. This may take the form of 1% margin during the week and if you intend to hold the position over the weekend it may rise to 2% or higher. Also in the example we have used a 1% margin. This is by no means standard. I have seen as high as 0.5% and many between 3%-5% margin. It all depends on your broker.

There have been many discussions on the topic of margin and some argue that too much margin is dangerous. This is a point for the individual concerned. The important thing to remember as with all trading is that you thoroughly understand your brokers policies on the subject and you are comfortable with and understand your risk.

Rollovers

Even though the mighty US dominates many markets most of Spot Forex is still traded through London in Great Britain. So for our next description we shall use London time. Most deals in Forex are done as Spot deals. Spot deals are nearly always due for settlement two business days day later. This is referred to as the value date or delivery date. On that date the counterparties take delivery of the currency they have sold or bought.

In Spot FX the majority of the time the end of the business day is 21:59 (London time). Any positions still open at this time are automatically rolled over to the next business day, which again finishes at 21:59. This is necessary to avoid the actual delivery of the currency. As Spot FX is predominantly speculative most of the time the trades never wish to actually take delivery of the actual currency. They will instruct the brokerage to always rollover their position. Many of the brokers nowadays do this automatically and it will be in their polices and procedures. The act of rolling the currency pair over is known as tom.next which, stands for tomorrow and the next day. Just to go over this again, your broker will automatically rollover your position unless you instruct him that you actually want delivery of the currency. Another point noting is that most leveraged accounts are

unable to actual deliver of the currency as there is insufficient capital there to cover the transaction.

Remember that if you are trading on margin, you have in effect got a loan from your broker for the amount you are trading. If you had a 1 lot position your broker has advanced you the \$100,000 even though you did not actually have \$100,000. The broker will normally charge you the interest differential between the two currencies if you rollover your position. This normally only happens if you have rolled over the position and not if you open and close the position within the same business day.

To calculate the broker's interest he will normally close your position at the end of the business day and again reopen a new position almost simultaneously. You open a 1 lot (\$100,000) EUR/USD position on Monday 15th at 11:00 at an exchange rate of 0.9950. During the day the rate fluctuates and at 22:00 the rate is 0.9975. The broker closes your position and reopens a new position with a different value date. The new position was opened at 0.9976 a 1 pip difference. The 1 pip difference reflects the difference in interest rates between the US Dollar and the Euro. In our example your long Euro and short US Dollar. As the US Dollar in the example has a higher interest rate than the Euro you pay the premium of 1 pip.

Now the good news. If you had the reverse position and you were short Euors and long US Dollars you would gain the interest differential of 1 pip. If the first named currency has an overnight interest rate lower than the second currency then you will pay that interest differential if you bought that currency. If the first named currency has a higher interest rate than the second currency then you will gain the interest differential.

To simplify the above. If you are long (bought) a particular currency and that currency has a higher overnight interest rate you will gain. If you are short (sold) the currency with a higher overnight interest rate then you will lose the difference.

I would like to emphasis here that although we are going a little in-depth to explain how all this works, your broker will calculate all this for you. The purpose of this book is just to give you an overview of how the forex market works.

Accounts

Although the movement today is towards all transaction eventually finishing in a profit and loss in US Dollars it is important to realize that your profit or loss may not actually be in US Dollars. From my observation the trend is more pronounced in the US as you would expect. Most US based traders assume they will see their balance at the end of each day in US Dollars. I have even spoken with some traders who are oblivious to the fact the their profit might have actually been in Japanese Yen.

Let me explain a little more. You sell (go short) USD/JPY and as such are short USD and Long (bought) JPY. You enter the trade at 116.10 and exit 116.90. You in fact made 80,000 Japanese Yen (1 lot traded) not US Dollars. If you traded all four major currencies against the US Dollar you would in fact have made or lose in EUR, GPY, JPY and CHF. This might give you a ledger balance at the end of the day or month with four different currencies. This is common in London. They will stay in that currency until you instruct the broker to exchange the currency you have a profit or loss into your own base currency. This actually happened to me. After dealing with mainly US based brokers it had never occurred to me that my statement would be in anything other than US Dollars. This can work for you or against you depending on the rate of exchange when you change back into your home currency. Once I knew the convention I simply instructed the broker to change my profit or loss into US Dollars when I closed my position. It is worth checking how your broker approaches this and simply ask them how they handle it. A small point but worth noting.

It's a sad fact that for many years the forex market largely remained unregulated. Even today there are many countries that still don't regulate companies that trade forex. London has been regulated for many years and the US is now getting its act together and has also started regulating companies dealing forex. It was only recently in the US you could with no more than an Internet site and a few thousand dollars set up your own forex operation and give the impression that you were larger than you are. I am all for the entrepreneurial flair and everyone need to start somewhere but when dealing with people's money it is imperative that the company you choose is solid.

Preferably you want a company that is regulated in the country that it operates, insured or bonded and has some kind of track recorded. I cannot advise you on which broker you should use as there are just too many variables to each person, but as a rule of thumb, nearly all countries have some kind of regulatory authority who will be able to advise you. Most of the regulatory authorities will have a list of brokers that fall within their jurisdiction and will give you a list. They probably won't

tell whom to use but at least if the list came from them you can have some confidence in those companies. Once you have a list give a few of them a call, see who you feel comfortable with, ask for them to send you their policies and procedures. If you live near where your broker is based, go spend the day with him. I have been to many brokerages just to check them out. It will give you a chance to see their operation and meet their team.

This brings up another interesting point. When you open an account with a broker you will have to fill in some forms basically stating your acceptance of their policies. This can range from a 1 page document to something resembling a book. Take the time to read through these documents and make a list of things you don't understand or want explained. Most reputable companies will be happy to spend some time with you on this. Your involvement with your broker is largely up to you. As a forex trader you will probably spend long hours staring at the screen without talking to anyone. You may be the sort of person who likes this or you may be the sort of person who likes to chat with the dealer in the trading room. You will normally get a call once a week or once a month from someone in the brokerage asking if everything is OK.

Statements

Before we move on to account statements I just want to touch on segregation of funds. In times past there was a danger that traders who deposited money with their broker who did not segregate their clients money from their own companies money were at some risk. The problem arose if the broker misused the deposited funds to either reinvest or otherwise manipulated these deposits to enhance their own standing. There were also instances where the broker became insolvent and many complications ensued as to what was the client's money and what was the broker's money. With the advent of regulation most brokers now segregate their client's funds from the brokerage funds. Deposits are normally held with banks or other large financial institution that are also regulated and bonded or insured. This protects your money should anything happen to your broker. The deposit taking institution is normally aware that these deposits are client's funds. Depending on regulation in the particular country you live, each client may have their own segregated account or for smaller depositors they may be pooled. The point is that segregation of funds is a safeguard. Ask your broker if your funds are segregated and who actually has your money.

Just as with a bank you are entitled to interest on the money you have on deposit. Some broker may stipulate that interest is only payable on accounts over a certain amount but the trend today is that you will earn interest on any amount you have that is not being used to cover your margin. Your broker is probably not the most competitive place to earn interest but that should not be the point of having your money with him in the first place. Payment on your account that is not being used and segregation of funds all go to show the reputability of the company you are dealing with.

In this section I will discuss briefly the basic account statement. I have to keep this basic as there are as many flavors of account statements as you can imagine. Just about every broker has their own way of presenting this. The most important thing is to know where you stand at the end of each day or week. Just because your broker is Internet based and has all the bells and whistles does not mean they are infallible. Many of the actions taken before information is imputed are still done by hand and if humans are involved there will be a mistake at some point. The responsibility lies with you. It is your money so make sure that all the transactions are correct.

FX Some Company New York Statement for: Mr. Joe Bloggs Statement Date: 16th July 2002 Account No: 123456 Summary Of All Trades From: 15/07/02-17/07/02

Ticket No	Time	Trade Date	Value Date	B/S	Symbol	Quantity	Rate	Debit	Credit	Balance
123458	09:05	15/07/2002	17/07/02	B	EUR/USD	100,000	0.9850	.	.	\$10,000
123459	13:01	15/07/2002	17/07/02	S	EUR/USD	100,000	0.9870	.	\$200.00	\$10,200
123460	14:05	16/07/2002	18/07/02	S	USD/JPY	100,000	116.85	.	.	\$10,200
Total Equity		\$10,200								
Margin Available		\$9,200								
Margin Requirements		\$1,000								
Current Position		Short USD/JPY								

Normally there is a ticket or docket number to help identify the trade. You will nearly always find the time and date of the trade. The value date if the currency were to be delivered. You should always see the direction of the trade, buy or sell (Long or Short). The amount and rate you bought or sold. The balance, to let you know if you made a profit or a loss. You should also see any open positions you

may have and the margin requirements for that position. A lot of the more modern systems will show your open position as though it has been closed just to give you an up to the minute balance.

The Main Players

Central Banks and Governments

Policies that are implemented by governments and central banks can play a major roll in the FX market. Central banks can play an important part in controlling the country's money supply to insure financial stability.

Banks

A large part of FX turnover is from banks. Large banks can literally trade billions of dollars daily. This can take the form of a service to their customers or they themselves speculate on the FX market.

Hedge Funds

As we know the FX market can be extremely liquid which is why it can be desirable to trade. Hedge Funds have increasingly allocated portions of their portfolios to speculate on the FX market. Another advantage Hedge Funds can utilize is a much higher degree of leverage than would typically be found in the equity markets.

Corporate Businesses

The FX market mainstay is that of international trade. Many companies have to import or exports goods to different countries all around the world. Payment for these goods and services may be made and received in different currencies. Many billions of dollars are exchanged daily to facilitate trade. The timing of those transactions can dramatically affect a company's balance sheet.

The Man In The Street

Although you may not think it the man in the street also plays a part in today's FX world. Every time he goes on holiday overseas he normally need to purchase that country's currency and again change it back into his own currency once he returns. Unwittingly he is in fact trading currencies. He may also purchase goods and services whilst overseas and his credit card company has to convert those sales back into his base currency in order to charge him.

Speculators and Investors

We shall differentiate speculator from investors here with the definition that an investor has a much longer time horizon in which he expects his investment to yield a profit. Regardless of the difference both speculators and investors will approach the FX market to exploit the movement in currency pairs. They both will have their reason for believing a particular currency will perform better or worse as the case may be and will buy or sell accordingly. They may decide that the Euro will appreciate against the US Dollar and take what is called a long position in Euro. If the Euro does in fact gain ground against the US Dollar they will have made a profit.

What Next?

Well now we have a basic understanding of how the FX market works and who the main players are, what next? You are now going to have to decide the best way to trade the market. The two most common approaches are that of fundamental analysis and technical analysis.

Fundamental analysis concentrates on the forces of supply and demand for a given security. This approach examines all the factors that determine the price of a security and the real value of that security. This is referred to as the intrinsic value. If the intrinsic value is below the market price then there is an opportunity to buy and if the market is above the intrinsic price then there is an opportunity to sell.

Technical analysis is the study of market action, mainly through the use of charts and indicators to forecast the future price of a security. There are three main points that a technical analyst applies. A. Market action discounts everything. Regardless of what the fundamentals are saying, the price you see is the price you get. B. The price of a given security moves in trends. C. The historical trend of a security will tend to repeat.

Of all of the above things the most important of them is point A. The tools of the technical analyst are indicators, patterns and systems. These tools are applied to charts. Moving averages, support and resistance lines, envelopes, Bollinger bands and momentum are all examples of indicators.

There are many ways to skin a cat as the saying goes but fundamental and technical analysis are the two most popular ways of trading FX.

Conclusion

Hope you have enjoyed this little ebook introducing you to the Forex market. This book is free and you may freely pass it on to your friends and associates.

Remember caution is the best way forward in trading. Don't risk money you can't afford to lose, don't trade with live cash until you have paper traded for at least three months and control your emotions.