

ABCs Of FOREX

By



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X-Trade Brokers India

Index

I.	<u>WHAT IS FOREIGN EXCHANGE (FOREX) TRADE?</u>	4
II.	<u>BRIEF HISTORY OF FOREIGN EXCHANGE</u>	4
III.	<u>FOREIGN EXCHANGE –SIZE AND SCOPE</u>	4
IV.	<u>HOW DOES THE CURRENCY MARKET WORK?</u>	5
V.	<u>WHAT DOES ‘EXCHANGE-RATE’ MEAN?</u>	5
VI.	<u>MEASURING CURRENCY MOVEMENTS</u>	6
VII.	<u>HOW FOREX TRADE WORKS?</u>	6
VIII.	<u>UNDERSTANDING SPREADS AND MARGINS</u>	7
	A) SPREADS	7
	B) MARGINS	8
IX.	<u>LONG/SHORT POSITIONS & CLOSE A POSITION OR ROLLOVER</u>	8
X.	<u>ANALYZE THE CURRENCY MARKET</u>	9
	A) FUNDAMENTAL ANALYSIS	10
	B) TECHNICAL ANALYSIS	10
XI.	<u>DEALING DETAILS</u>	10
	A) HOW TO OPEN AN ACCOUNT	10
	B) TRADING SCREENS	11
	C) TYPES OF ORDERS	11
	A) ORDER USED TO ENTER POSITIONS	11
	B) ORDER USED TO EXIT POSITIONS	13
XII.	<u>RISK MANAGEMENT</u>	14
XIII.	<u>FOREX TRADE – EXAMPLE</u>	15
XIV.	<u>FOREX VERSUS STOCKS</u>	15
	A) PROFIT IN BEARISH AND BULLISH MARKETS	15
	B) NO COMMISSIONS AND NO EXCHANGE FEES CHARGED	15
	C) UP TO 100 TIMES THE LEVERAGE.....AND POTENTIAL PROFITS	16
	D) FOREX MAKES MONEY ON THE INTEREST-RATE NEWS	16
	E) TRADERS CAN EASILY DIVERSIFY OUT OF US DOLLARS	16
	F) FOREX – PERFECT FOR TECHNICAL TRADERS	16
	G) ANALYZE A NATION LIKE A CORPORATION	16
	H) FOREX CAN BE TRADED 24 HOURS A DAY	16

XV. FOREX V/S FUTURES	17
A) ZERO COMMISSION AND EXCHANGE FEES	17
B) FOREX PROVIDES MORE LEVERAGE	17
C) FOREX PROVIDE LESS LIABILITY	17
D) FOREX HAS MAXIMUM LIQUIDITY	18
E) TRADER CAN EARN A PROFIT IN CASE OF FOREX ROLLOVERS	18
F) FOREX TRADE CAN BE DONE 24 HOURS A DAY	18

I. WHAT IS FOREIGN EXCHANGE (FOREX) TRADE?

Foreign exchange trade is the simultaneous buying of one currency and selling of another at a specific rate.

Foreign Exchange (FOREX) trade is the simultaneous buying of one currency and selling of another. The same is done at a specific rate, which is determined by economic, political and social factors that drive the demand and supply in an economy. This rate is known as the exchange rate and is formally defined as the value of one currency in terms of another.

II. BRIEF HISTORY OF FOREIGN EXCHANGE

- Foreign exchange has been monitored by several international monetary systems which have been enforced from time to time. These include the Gold Standard, the Gold-Exchange Standard and the Bretton Woods Systems, where the rates were usually fixed by the government.
- Withdrawal of the Bretton Woods Agreement in 1971, led to the emergence of the modern era of foreign exchange, where floating rates are used, which meant that the market participant decide on the price by buying and selling currencies.
- Elimination of government controls and restrictions, deepening trend towards international trade liberalization and advances in technology signalled the true beginning of the free - floating currency exchange system that drives the markets today.
- Today, intervention is available to the states only through their central banking system.

III. FOREIGN EXCHANGE –SIZE AND SCOPE

- Forex market is the largest and most liquid market in the world. Its daily turnover dwarfs the turnover of the U.S. Treasury and Stock Market combined.
- The daily dollar volume of currencies traded in the currency market exceeds \$3.21 trillion. The \$3.21 trillion break-down is as follows:
 - \$1.005 trillion in spot transaction
 - \$0.362 trillion in outright forwards
 - \$1.714 trillion in foreign exchange swaps
 - \$0.129 trillion estimated gaps in reporting
- The daily turnover of Forex markets is nearly 21% of the entire GDP of the US.

IV. HOW DOES THE CURRENCY MARKET WORK?

- The currency market is an off-exchange market that operates 24 hours a day.
- The primary currency market is the inter-bank market
- The secondary market is an over-the-counter market

The off-exchange forex market is large, growing and liquid financial market that operates 24 hours a day. It is not a market in the traditional sense because there is no central trading location or 'exchange'. Most of the trading is done through telephones, faxes or through electronic trading networks.

The primary market for currencies is the 'interbank market' where banks, insurance companies, large corporations and other large financial institutions manage the risks related to foreign exchange rate fluctuations. The true interbank market is only available to institutions that deals in large quantities and have a very good network.

In recent years a secondary OTC (over-the-counter) market has developed. Over-The-Counter (OTC) or off-exchange trading is to trade financial instruments such as forex, stocks, bonds, commodities or derivatives directly between two parties. OTC permits retail investors to trade in forex. These retail investors trade in the secondary market with brokers through electronic trading networks. The brokers, in turn trade with the market-makers/banks in the primary market.

V. WHAT DOES 'EXCHANGE-RATE' MEAN?

- The 'base currency' is the term used for the first currency in the pair.
For example in a EUR/USD pair, EUR is the base currency.
- The 'counter currency' is the term used for the second currency in the pair.
For example in a EUR/USD pair, USD is the counter currency.
- The 'exchange rate' represents the number of units of the counter currency that one unit of the base currency can purchase.
For example, the exchange rate of EUR/USD = 1.2533, i.e. 1 unit of EUR will fetch you 1.2533 units of USD

Currency trading, in the forex market, is always done in pairs, such as EUR/USD (or USD/JPY). Accordingly, all trades result in the simultaneous buying of one currency and the selling of another. The base currency is the 'base' for the buy or the sell. It is useful to consider the currency pair as an instrument, which can be bought or sold.

The first currency in the pair is referred to as the base currency, and the second currency is the counter or quote currency. The U.S Dollar, as the world's dominant currency, is usually considered the base currency for quotes, and includes USD/JPY, USD/CHF, and USD/CAD. This means that quotes are expressed as a unit of \$1 USD per the other currency quoted in the pair. The exceptions are the Euro, Great Britain pound, and Australian dollar. These currencies are quoted as dollars per foreign currency. As with all financial products, forex quotes include a

“bid” and “ask.” The ‘bid’ price at which a market maker is willing to buy (and the trader can sell) is the base currency in exchange for the counter currency. The ‘ask’ is the price at which a market maker will sell (and the trader can buy) the base currency in exchange for the counter currency. The difference between the bid and the ask price is referred to as the spread.

The following are examples of situations that might lead a trader to choose the currency pair which he wants to trade in:

EUR/USD

If, for example, a trader thinks that US stock market will continue to fall and that will hurt the USD, he will buy Euros expecting them to go up against the USD. If he sells Euros he would be buying US Dollars expecting them to climb against the Euro.

USD/JPY

If, for example, a trader thinks that the Japanese government is going to weaken the Yen in order to help their export industry, he will buy USD, expecting the US Dollar to increase in value against the Yen. If he thinks that Japanese investors are pulling money out of US financial markets and repatriating funds back to Japan he would sell USD, expecting the Yen to strengthen against the US Dollar as Japanese investors sell their assets and convert their dollars to Yen.

VI. MEASURING CURRENCY MOVEMENTS

- Pip is the unit of measurement for the exchange rate movement.
- The number of pips a currency pair moves determines how much a trader will earn or lose on the position.

A pip is the last significant digit in an exchange rate, and is the term used to define the unit of measurement for the exchange rate movement. The number of pips that the exchange rate moves dictates how much a trader has gained or lost through an FX trade. In the example above, if the rate moves from 1.5755 to 1.5855, the pair has risen by a 100 points or pips.

VII. HOW FOREX TRADE WORKS?

Any Foreign exchange transaction ultimately begins with two events:

- One currency is being borrowed.
- The proceeds from the borrowed currency are used to finance the currency that is being bought

Currency pairs are typically traded in quantities of 100,000 units or 10,000 units of the base currency. A 100,000 unit quantity in a currency trade is referred to as a lot. (For example, a trading 5 lots is trading 500,000 units of currency).

After gaining an intuitive understanding of how exchange rates move, one can begin FX trading, thereby speculating on the exchange rate so as to potentially reap profits from the fluctuating value of currencies. Essentially, clients can borrow one currency and buy another, and profit from exchange rate movements.

This concept is most easily explained and understood through an example of an actual trade:

Let us consider that Trader A wishes to speculate on GBP/USD. Believing that the GBP will rise against the USD or that the exchange rate will move upwards, the trader places an order to buy GBP/USD at a market 1.5755. In terms of volume, let's assume that Trader A is speculating on 100,000 units of the base currency- which is the standard lot size, or trading quantity, used in the foreign exchange market. Since the base currency is the first currency in the pair, we know that Trader A is speculating on the value of 100,000 British pounds with respect to the US dollar.

In this example, Trader A is buying British pounds, since he believes the pound will rise in value with respect to the US dollar. Accordingly, he finances the transaction of buying 100,000 pounds by borrowing an equivalent amount of US dollars.

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For Trader A, the value of the amount borrowed is a function of the exchange rate. Since the exchange rate at the time of the transaction was 1.5755, we know that the market cost for 1 British pound was 1.5755 US dollars. Hence, 100,000 pounds cost \$ 157,550 ($1.5755 * 100,000$). This borrowed amount of 157,550 USD must be paid back when the transaction is closed.

Let's assume that Traders A is correct in assuming that the British pound would rise in value with respect to the USD, and that the exchange rate moved to 1.5855 -100 pips above the rate at which Trader A entered. If Trader A were to close his position now, the 100,000 pounds he purchased at the onset of the transaction would be sold, and his debt of 157,550 dollars would be paid off.

At an exchange rate of 1.5855, Trader A's 100,000 pounds are now worth 158,550 US dollars ($100,000 * 1.5855$). After repaying the borrowed amount of 157,550 it leaves him with a profit of \$1,000.

VIII. UNDERSTANDING SPREADS AND MARGINS

A) SPREADS

Spread is the difference between the 'bid' and the 'ask' price. Spreads are measured in pips (smallest difference in prices movement).

Spread is the difference between the price that a trader can sell currency at (Bid) and the price he can buy currency at (Ask). Bid/Ask spreads are measured in pips (smallest difference in price movement). The dealing spreads is typically around three to four points in normal market conditions, for e.g. EURO/USD: 1.2232-34. This means that a trader can sell Euros against the US Dollars at 1.2232 and buy at 1.2234. There are no further costs, no commissions or exchange

fees involved in forex trade on X-Trader platforms (however, availing of services like dealing desk would cost a certain amount to the trader).

B) MARGINS (LEVERAGE)

A private investor, who purchases, say a GBP/USD lot, does not have to put down the full value of the trade. Instead, the buyer is required to put down a deposit known as “margin” which enables the investor to gear up the trade size to institutional level.

A private investor, who purchases, say a GBP/USD lot, does not have to put down the full value of the trade. Instead, the buyer is required to put down a deposit known as “margin” which enables the investor to gear up the trade size to institutional level. The normal margin requirement is 1% of the underlying value of the trade. The currency denomination depends on the brokerage through which the trader executes his trade. It is likely that he will have to deposit margin in USD.

With 5,000 USD in the margin account and with a margin requirement of 1%, a trader can open positions worth 500,000 USD. His positions will be valued continuously. If the funds in his margin account drop below the minimum amount required, supporting his open positions, then he may be asked to provide additional funds. This is known as a “margin call”.

IX. LONG/SHORT POSITIONS & CLOSE A POSITION OR ROLLOVER

- Going “long” on a currency = buying the base currency
- Going “short” on a currency = selling the base currency
- Close a position = conducting a trade which is equal and opposite of an open position when the trader wishes to take his profit/loss from the trade
- If the position is not closed till the end of the day, then the position is automatically rolled over to the next business day
- The trader earns/pays an interest on the rolled over position as a result of the interest rate differentials between the currencies

When a trader buys a currency, he is said to be “long” in that currency. Long positions are entered into at the offer price. Thus if a trader is buying one GBP/USD lot quoted at 1.5847/52, then he will buy 100,000 GBP at 1.5852 USD. Similarly, when he sells a currency, he is said to be “short” in that currency. Short positions are entered into at the bid price, which is 1.5847 USD, in this case.

Because of the symmetry of currency transactions, a trader is always simultaneously long in one currency and short in another. For example if he exchanges 100,000 GBP for USD, he is short in sterling (GBP) and long in US dollars.

An open position is one that is live and ongoing. As long as the position is open, its value will fluctuate in accordance with the exchange rate in the market. Any profits and losses will exist on paper only and will be reflected in the trader’s margin account. To close out his position, he conducts an equal and opposite trade in the same currency pair. For example, if a trader has

gone long in one lot of GBP/USD (at the prevailing offer price), he can close out that position by subsequently going short in one GBP/USD lot at the prevailing bid price. The opening and closing trades must be conducted through the same intermediary. A trader cannot open a GBP/USD position with Broker A and close it out through Broker B.

All trades in the spot foreign exchange market must be settled within two business days. Trades can be settled by the full delivery of the sold currency, or the position can be rolled over. At 5:00pm Eastern Standard Timeⁱ, all open positions are automatically rolled over to the next settlement day by exchanging them for a new position that expires on the following settlement date. From day to day these positions are valued differently. Significant differences can emerge based on the currency pair, interest rate differentials, and other daily fluctuation.

On Wednesdays, the volume of funds added or subtracted from an account is thrice. This accounts for settlement of trades through the weekend period.

The following is a simple example of how interest rollover is calculated:

[No. of Lots x No. of Units per lot x Yearly Interest Rate Differential] / [360 x No. of Days]

Example:

Transaction: Sell 2 lots of USD/JPY on Monday and settle on the next day.

Lot Value: USD 100,000 or JPY 9,200,000

Opening Price: USD/JPY = 92.00

Yearly Interest Rate Differential, USD 0.25% - JPY 0.10% = 0.15%

Calculation: $USD\ 100,000 \times 2 \times (-0.15\%) / [360 \times 1] = -0.83\ USD$ (i.e. pay 0.83 USD per day as Rollover charges)

X. ANALYZING THE CURRENCY MARKET

There are two approaches to analyzing the currency markets,

- The fundamental analysis, and
- The technical analysis.

Fundamental analysis concentrates on the underlying causes of the price movement.

Technical analysis, on the other hand, studies the price movements in the past and helps in predicting the future price movements based on the past trends.

A) FUNDAMENTAL ANALYSIS

Fundamental analysis deals with the factual influences on the market and the trader will aim to predict economic developments, which will have an impact on the direction of foreign exchange rates. The analysis focuses on the economic, social and political forces that drive demand and supply. It considers macroeconomic factors such as economic growth, unemployment, interest rates, inflation, etc.

B) TECHNICAL ANALYSIS

Technical Analysis is the study of past price and activity, in order to predict future price movements. The basic premise of technical analysis is that the price discounts all information available in the market and the pattern in price movements tend to repeat themselves. Historical data is used to forecast the direction of future prices. The primary tools of technical analysts are chart. Charts are used to identify trends and patterns in order to find profit opportunities.

Both the above analysis can be learned through XTB online free webinars conducted regularly. Check our websites for more details: <http://www.in.xtb.com/strona.php?p=724>

XI. DEALING DETAILS

A) HOW TO OPEN AN ACCOUNT

- The first step is to open an account with a broker or a market marker.
- XTB sends the account opening form/client agreement to the trader.
- The trader is supposed to send the filled form along with his identity-proof and address-proof. All the documents are to be scanned and sent to the XTB office.
- XTB office then confirms the receipt of the documents to the client via e-mail.
- The client can then transfer money to HSBC HK through his bank.
- On confirmation of receipt of the money in HSBC HK, a username and a password, to the trading station is generated and sent to the client. On receipt of these details, the client can commence trading on X-Trader Platform.

Every individual who wishes to trade in foreign exchange needs to have an account with a broker. The same can be done online by accessing the site of the concerned broker. Further he should deposit the requisite amount of money with the trader's bank to enable him to commence trading. For example, if a trader wants to hold positions worth USD 700k, and the margin requirement of the broker is 1% then the trader is required to hold in his account an amount of USD 7,000 as margin money for the open positions and also some additional amount for adjustment of profits and losses incurred as a result of the open trades.

It is suggested, that you should pay in some excess capital, above the expected margin, for safety and further transactions.

B) TRADING SCREENS

The trading screen is where the trader monitors bid and offer prices in multiple currency pairs. A typical Electronic Broking System - style screen format which highlights the “pips” (i.e. the third and fourth decimal places) where most of the movement takes place. After a complete analysis of the market, all the trader has to do is pick his movement and buy or sell the instrument which he wants to trade in.

C) TYPES OF ORDERS

The term “order” refers to how a trader can enter or exit a position in the market. There are various ways of placing orders, and understanding the pros and cons of various order types, is a key to becoming a savvy trader.

A) ORDER USED TO ENTER POSITIONS

The following are orders that can be used to enter positions:

1) MARKET ORDER

- Advantage: Ensures trader that he/she will be able to execute a trade and take a position in the market
- Disadvantage: Far greater likelihood that trader is not getting the best price for the trade, or is assuming unnecessary risk.

A market order is an order to buy or sell a currency pair at the current market price. For example, the forex trading station will always show two prices for every currency pair—the price at which a trader can buy (also known as the ask), and the price at which he can sell (also known as the bid). For instance, the market could be pricing the EUR/USD at 1.2200 – 1.2205—meaning traders can buy the EUR/USD at 1.2205, but would have to sell at 1.2200.

These prices represent the current market prices, and traders who choose to enter market orders would be filled at the rate they see. The key advantage of market orders is that they ensure the trader that he/she will be in the position. The key disadvantage, though, is that the trader may not get the best price he/she could have gotten had he/she used another order type. Another disadvantage – and one that is often overlooked – is that market orders are more conducive to being used recklessly and without discipline. Using other orders, like stop and limit orders, are better-suited for helping trading stay disciplined.

2) ENTRY ORDER

- Advantage: Greater likelihood that the trader will get the price he/she wants.
- Disadvantage: Market may not reach the rate the trader specified, and hence the trader may miss out on the opportunity.

All entry orders are essentially contingent orders; they will only be filled if the market reaches the rate specified.

For example, suppose a trader is trading USD/JPY, and the current quote is 120.50-55.

He can place an entry order to buy at 120.15, so that this order will only be filled if the market reaches 120.15. This allows him to potentially receive a better price.

There are two types of entry orders: limit entry orders and stop entry orders.

3) LIMIT ENTRY ORDERS

Limit entry orders are classified as entry orders whereby the rates specified by the trader is either (1) below the current market rate, if it is a buy order, or, (2) above the market rate if it is a sell order. Essentially, limit entry orders should be used if the trader is expecting the market to reverse its direction at a certain rate. For example, if the USD/JPY is trading at 120.50 and the trader expects it to fall to 120.15 before reversing its direction, the trader would place a limit entry to buy at 120.15. Or, if the trader expects the rate to rise to 120.70 before falling, the trade would place a limit entry to sell at 120.70. In both cases, the trader is expecting a reversal at a certain level – and hence is using a limit entry order.

4) STOP ENTRY ORDERS

Stop entry orders rely on rationale that is the opposite of limit entry orders; they involve either (1) Placing orders to buy above the current market rate or (2) placing order to sell below the current market rate. While limit entry orders can be used if a trader is expecting a reversal, stop entry orders should be used if the trader is expecting continuation of a trend beyond a certain point. As a result, stop entry orders are often safer; they allow a trader to enter positions only after the market has reached a certain rate and confirmed the strength of the trend.

Consider an example:

Suppose the current market rate for USD/JPY is at 117.04-09. In other words, a trader can enter the market to sell at 117.04 or buy at 117.09. There are two types of stop entry orders that a trader could place in such a situation:

- He could place an order to sell at a price below the current market rate, i.e., he could place an order to sell at 116.75; if the sell rate in the spot market reaches 116.75, his sell order would be executed.
- Alternatively, he can place an order to buy above the current market rate, i.e. he could place an order to buy at 117.50, and his order would only be filled if the market reached this rate.

In either case, the trader expects that the market will reach this level; it will break out and continue in the same direction.

B) ORDER USED TO EXIT POSITIONS

The following are orders that can be used to exit positions:

1) LIMIT ORDERS (OR TAKE-PROFIT ORDER)

- Advantage: Helps trader maintain discipline, and is an effective way to lock-in profits.
- Disadvantage: May lead to premature profit-taking, as traders may end up getting out of positions with lesser profits.

A limit order allows a trader to specify the rate at which he will take profits and exit the market. Essentially, it defines the amount of profit that the trader is looking to capture on the particular trade.

For example, a trader has an open position where he is long (meaning he has bought) GBP/USD at 1.5800. In such a scenario, the trader can place a limit order to determine at what rate he will close his position and take his profits. So, for instance, if the aforementioned trader was looking to capture 100 pips on the GBP/USD, he would place a limit order 1.5900. If the market reached that rate, he would be taken out of the market, and his profit from the trade would immediately be reflected in his balance.

Limit orders are great tools to help traders maintain discipline and lock-in profits. Still, though, they may result in premature profit-taking — meaning they may cause traders to exit positions too early with profits that are too small relative to the risk involved in assuming the position.

2) STOP-LOSS ORDER

- Advantage: Allows trader to specify the maximum loss he/she is willing to make on a position
- Disadvantage: Stops placed too tight may result in the trader being taken out of the market, only to see the market reverse its direction and head in the direction the trader originally forecasted.

It works like a limit order, but in an opposite fashion. It specifies the maximum loss that a trader is willing to accept on a given position.

For example, if a trader is long USD/JPY at 121.50, with a limit at 121.70, he may wish to maximize the loss he is willing to accept by placing a stop-loss order at 121.30. In such a case, if the market reached 121.30, he would be stopped out of the position and would suffer a loss no greater than 20 pips. Similarly, if a trader is short USD/JPY at 121.50 with a limit at 121.30 and only wants to suffer a loss of 20 pips, then he would place a stop loss order at

121.70. Accordingly, if the market reaches 121.70 the trader will be stopped out of the position and would have suffered a loss no greater than 20 pips.

Stop-Loss orders are one of the most highly recommended tools for traders. They are crucial in ensuring that the trader does not blow up his/her account with a single trade. On the downside, stop-loss orders, if not placed at the appropriate level, can result in traders being taken out of positions at a loss – when in fact the market may reverse itself.

XII. RISK MANAGEMENT

Risk will essentially be controlled in two ways:

- By exiting losing trades before losses exceed the trader's pre-determined maximum tolerance or 'Cutting losses' (stop-loss and limit orders are used to restrict losses), and
- By limiting the position size of the trades for a given account size

Most traders lose money simply because they have no understanding or place no importance in risk management. Risk management essentially knows how much you are willing to risk and how much you are looking to gain.

So, what can traders do to ensure they have solid money management habits?

There are a few key guidelines that every trader, regardless of their strategy or what they are trading, should keep in mind:

- Risk-Reward Ratio: Traders should look to establish a risk-reward ratio for every trade they place. In other words, they should have an idea of how much they are willing to lose, and how much they are looking to gain. Generally, the risk-reward ratio should be 1:3, if not more. Having a solid risk-reward ratio can prevent traders from entering positions that ultimately are not worth the risk.
- Stop-Loss Orders: Traders should also employ stop-loss orders as a way of specifying the maximum loss they are willing to accept. By using stop-loss orders, traders can avoid the common predicament of being in a scenario where they have many winning trades but a single loss large enough to eliminate any trace of profitability in the account.

Your risk per trade should not increase 3%. Ideally, you should adjust your risk at 1% to 2%

Example:

1% risk of a \$100,000 account = \$1,000

You should adjust your stop loss so that you never lose more than 1,000\$ per trade.

Say, you place your stop loss at 100 pips below/above your entry point and,

100 pips = 1,000\$

1 pip = 10\$

The size of your trade should be adjusted so that you risk 10\$/pip. With 100:1 leverage, your trade size will be 100,000\$

If the trade is stopped, you will lose 1,000\$ which is 1% of your balance

XIII. FOREX TRADE – EXAMPLE

Betting on a Rise:

- Assume that you start with a clean slate and that the current GBP/USD rate is 1.5847/52.
- You expect the pound to appreciate against the US dollar, so you buy a single lot of 100,000 GBP at the offer price of 1.5852 USD.
- The value of the contract is $100,000 \times \$1.5852 = \$158,520$. The broker wants margin of 1% in USD, so you must ensure that you deposit at least 1% of 158,520 USD = 1,585.2 USD in your margin account
- GBP/USD duly appreciates to 1.6000/05 and you decide to close out your position by selling your sterling for US dollars at the bid rate. Your gain is :
 $100,000 \times (1.6000 - 1.5852) \text{ USD} = 1,480 \text{ USD}$ the equivalent of 10 USD per pip
- Your rate of return is $1,480 / 1585.2 = 93.36\%$, on an exchange rate movement of less than 1%.

This illustrates the positive effect of buying on margin.

XIV. FOREX VERSUS STOCKS

A) PROFIT IN BEARISH AND BULLISH MARKETS

Unlike the equity market, in the forex market, there is no short selling restriction. There is potential for profit in currencies regardless of which way the market moves. Forex always involves selling one currency to buy another, so there is no structural bias to the market. Depending on short and long positions, a trader always has an opportunity to profit in a fluctuating market.

B) NO COMMISSIONS AND NO EXCHANGE FEES CHARGED

Online trading of currencies, involves payment of zero Commission and 'Exchange and Clearing' fees to trade currencies online. In the equity markets, payment of both commission and a spread is mandatory. Over-The-Counter (OTC) structure of the forex market eliminates exchange and clearing fees, which in turn lowers transaction costs. Costs are further reduced by the efficiencies created by a purely electronic market place that allows clients to deal directly with the market maker. Because the currency market offers round-the clock liquidity, traders receive tight competitive spreads, both intra - day and night. Stock traders are more vulnerable to liquidity risk and typically receive wider trading spreads, especially during after-hours trading.

(Commissions would be charged only in case of additional services, like dealing desk service provided.)

C) UP TO 100 TIMES THE LEVERAGE.....AND POTENTIAL PROFITS

Trading forex with XTB, gives up to 100 times the leverage of trading stocks. In equities, for every \$1,000 a trader invests, he controls a maximum of \$2,000 worth of equity. The leverage is 2:1. But with forex, if a trader invests \$1,000 margin on a foreign currency trade, he can control up to \$100,000 in currencies.

D) FOREX MAKES MONEY ON THE INTEREST-RATE NEWS

If the market has uncertainty regarding the interest-rates, then any bit of news regarding interest-rates can directly affect the currency market. Traditionally, if a country raises its interest-rate, the currency of that country tends to gain a higher return. Hikes in interest-rates however, are generally bad news for stock markets. Some investors will transfer money out of a country's stock market when interest rates are hiked, causing the country's currency to weaken.

E) TRADERS CAN EASILY DIVERSIFY OUT OF US DOLLARS

The trade balance shows the net difference over a period of time between a nation's exports and imports. When a country imports more than it exports, the trade balance will show a deficit, which is generally considered unfavourable to that nation's currency. Many investors know that they should diversify some of their assets into foreign currencies, but to do so is difficult. Most U.S. banks, for example, do not offer foreign currency accounts. However, by trading forex, traders can instantly control hundreds of thousands of dollars worth of foreign currencies. For every \$1,000 margin deposit, a trader can control up to \$100,000 worth of Euros...or British Pounds... or whatever currency he believes will rise in the future.

F) FOREX – PERFECT FOR TECHNICAL TRADERS

Unlike stocks, currencies rarely spend much time in tight trading ranges and have the tendency to develop strong trends. Over 80% of volume is speculative in nature and, as a result the market frequently overshoots and then corrects itself. A technically trained trader can identify new trends and breakouts, which provide multiple opportunities to enter and exit positions.

G) ANALYZE A NATION LIKE A CORPORATION

Currencies are traded in pairs, so if a trader 'buys' one currency he is simultaneously 'selling' the other. As with a stock investment, it is better to invest in the currency of a country that is growing faster and is in a better economic condition. Currency prices reflect the balance of supply and demand for currencies. Two primary factors affecting supply and demand are interest rates and the overall strength of the economy. Economic indicators such as GDP, foreign investment, and the trade balance reflect the general demand for that currency. There is a tremendous amount of data released at regular intervals, some of which is more important than others. Data related to interest rates and international trade is looked at the closest.

H) FOREX CAN BE TRADED 24 HOURS A DAY

Forex trading is a window to the world economy. Trading starts on Sunday at 5:00pm Eastern Time with the opening of the markets in Sydney. A couple of hours later, the Tokyo market opens and so on, depending on the location of the various countries. By the time the day catches up to New York, the world currency markets have been at work for fifteen hours. You determine the timing of your trades, instantly reacting to any news or market pressure. Trading stocks when the markets are closed is not easy and does not provide much liquidity. With forex, you can trade 24-hours a day in the largest and most liquid market in the world.

XV. FOREX V/S FUTURES

A) ZERO COMMISSION AND EXCHANGE FEES

On X-Trader Platform, for a forex trade, the trader pays zero commission or exchange fees. Since the trader deals directly with the market maker via a purely electronic online exchange, he eliminates both ticket costs and brokerage fees. There is still a cost to initiating any trade, but that cost is reflected in the typical bid/ask spread that all platforms offer. However, forex trade offers tight and competitive spreads. Futures trade, on the other hand, involves compulsory payment of exchange and transaction fees.

B) FOREX PROVIDES MORE LEVERAGE

The sheer size of the forex market (46 times greater than all futures' markets combined) and the greater price stability allows a trader to trade with a much higher degree of leverage than is typical with futures contracts – up to 100:1. The trader controls the degree of leverage he wishes to employ in trading. For example, a US\$30,000 account has a margin requirement of US\$1,000 for every position held that is approximately equal to US\$100,000 worth of currencies. At this account level, 1% of total value of the currency traded is required to be maintained as margin on a leverage ratio of 100:1.

C) FOREX PROVIDE LESS LIABILITY

Trading spot forex with X-Trader Platform restricts the liability of the trader to the amount of principal invested by him in the trade. In the event that funds in the trader's account fall below margin requirements, the market maker will simply close all open positions. It means that, even if the trader's strategy proves to be wrong and there is a catastrophic market movement against his position, it is very unlikely, that he will lose more than the amount of money he has in his account. This provides a trader with tremendous peace of mind.

For example, you open an account with \$10,000. At this point your account balance and equity are both \$10,000, your useable margin is \$10,000 and your used margin is \$0, as you have yet to open a position. Next, you buy 7 lots of USD/JPY, which requires you to maintain \$7,000 in equity. Now your used margin is \$7,000 and your usable margin is \$3,000. Essentially, this means that you can sustain market losses totaling \$3,000 before your account equity falls below the minimum margin requirement of \$7,000, at which point the dealing desk will close all open positions thus eliminating any possibility of a debit balance in the trader's account.

D) FOREX HAS MAXIMUM LIQUIDITY

The forex market is the largest and most liquid market in the world, with spot foreign exchange market accounting for on average of \$1.5 trillion in transactions every day. The foreign exchange market can absorb transaction sizes and trading volumes that dwarf the capacity of the futures market.

E) TRADER CAN EARN A PROFIT IN CASE OF FOREX ROLLOVERS

Open positions are automatically rolled over every two days. At 5:00pm Eastern Time, the trader's account automatically rolls-over any open positions, swapping the trade to the next settlement date. Each currency has an overnight interest attached to it. With every currency transaction you are long one currency and short another. On X-Trader Platform, if you are long on the higher yielding currency, you will receive interest (subject to keeping a margin of 1% or more) and if you are short the higher yielding currency you will have to pay interest. The amount debited/credited to your account will depend on the interest rate differentials between the currencies being traded. However, rolling over of a position in a futures trade will only result in payout in the form of carrying costs.

F) FOREX TRADE CAN BE DONE 24 HOURS A DAY

The forex market is a seamless 24-hour, 5-Day (weekdays) market. At 5:00pm(ESTⁱ) Sunday, New York time, trading begins as markets open in Sydney. At 7:00pm (EST) Sunday, the Tokyo market opens, followed by 10:30pm(EST) Indian markets. Then Monday early morning London markets open at 2:00am(EST), and finally New York market at 8:00am(EST). Hence as a trader, one can react to favourable or unfavourable news by trading immediately. It also gives him the added flexibility of determining his trading day. He gets instantaneous execution and firm prices.

ⁱ To calculate the Indian Standard Time (IST), taking into consideration, the Daylight saving time in US, we add 11.5hrs to EST or else we add 10.5hrs to EST.