Introduction to Forex

GREENE CHARTER

What is Forex?

The foreign exchange market, also known as ‘FX’ & ‘forex’ deals with trading currencies such as USD, JPY, AUD. Forex isn’t limited to just EUR/USD, in the same sense that crypto isn’t limited to XBT or ETH.

Currencies are made up of many different participants. These include everyone from central banks, governments to small businesses who offer services in different countries and everyone in between.

Forex is a little different from most other markets since it’s not traded to speculate. Instead the vast majority of the volume occurs via spot, forwards and options contracts. For example a business based in Switzerland might sell goods in the UK (using GBP) and use forward contracts to lock in an exchange rate avoiding exposure to volatility of GBP/CHF

FX is the most liquid market on the planet, in September 2019 we saw daily volumes of $6.6 trillion traded. In comparison Bitcoin’s average volume in the last 3 months was $40.66 billion.

It is important to understand that volume of a market doesn’t translate to the liquidity you will be provided by your broker.

Speculating accounts for less than 5% of the total volume and retail speculation accounts for a fraction of that 5%. Currencies are being traded 24/7, however in relation to speculative trading the market is open almost 24 hours a day, 5-6 days a week (this depends on your broker).

Profiting in Low Beta Markets

Currency trading by nature means we are dealing with low volatility markets (low beta). A stock can rise 20% in a day and nobody will bat an eye but if a currency moves the same amount businesses, banks & economies will come crashing.

Forex on average, moves a fraction of a % daily, so instead of points or full numbers we measure FX in something known as 'pips'. A pip is the fourth decimal point, EUR/USD moving from 1.0870 to 1.0871, that 0.0001 rise in value is 1 pip.

This is the general rule in the market, but certain pairs are an exception to this, an example of this would be the Japanese Yen - a 0.01 fluctuation would be 1 pip. Thus, AUD/JPY moving from 71.73 to 71.53 is a 20 pip move.

Despite the low volatility, you do not need a lot of capital to trade FX as it's traded on margin, we are offered up to 500x. This depends on what country you live in, regulations & net worth (in certain countries you need a net worth above $500k to be able to trade with increased leverage).

In Forex everything is traded by the lot. A 'lot' refers to 100,000 units of the currency. Let's say we are long AUD/JPY with 5 lots; our position size would be worth 500k resulting in approximately 50$ per pip.

Using the 20 pips example from above - if we were long 5 lots on AUD/JPY from 71.53 and price ripped to 71.73. We would be up 20 pips, meaning we would net $1000 (50$ x 20 pips).

Time of Day

Liquidity tends to flow in during specific times of the day due to banking hours & news releases.

London Sessions starts at 07:00 UTC and ends at 16:00 UTC

New York Session starts at 13:00 UTC and ends at 22:00 UTC

Asian Session Starts at 23:00 UTC and ends at 03:00 UTC

News

Throughout the day we see news releases, it's not a big deal but there are a few events to watch out for such as Central Bank Announcements, Central Bank Rate Changes, President Speeches, Non Farm Payroll (NFP) etc.

As a rule of thumb I avoid NFP weeks after Wednesday's New York Session, avoid the day of FOMC, avoid any central bank rate changes & also president speeches. Around high impact news we see liquidity dry up as participants don't want exposure to risk, resulting in thinner books, this allows price to travel with less effort and that's why we see big moves around news.

A drop in liquidity means opportunity but it also means less favourable trading conditions as it's common to see wider spreads, slippage and even gaps. Missing out on these moves lets us stay in the game longer, providing us with more opportunity over the long run.

TradingView offers an economic calendar and so do most brokers and platforms, I personally use DailyFX & ForexFactory's calendar.

Currency Pairs

Currencies can be split up into 3 main areas:

Majors (EUR/USD, USD/JPY, GBP/USD, USD/CAD, USD/CHF, AUD/USD & NZD/USD)

Minors (EUR/GBP, EUR/CHF, EUR/CAD, EUR/AUD, EUR/NZD, EUR/JPY, GBP/JPY, CHF/JPY, CAD/JPY, AUD/JPY, NZD/JPY, GBP/CHF, GBP/AUD & GBP/CAD)

Exotics (EUR/TRY, USD/SEK, USD/NOK, USD/DKK, USD/ZAR, USD/HKD, USD/SGD)

Majors are the most liquid with generally the tightest spread followed by minors and then exotics.

For the most part we will be trading FX majors but occasionally will be trading FX Minors as they are the most consistent. Brokers

When deciding on a broker to use, evaluate against the following:

1. Is the broker regulated? Avoid if unregulated.
2. What are their spreads like for the currency pairs? The tighter the better.
3. What’s their fee structure like?
4. Do you like their platform?
5. Are they a market maker or do they give you direct access to the market ?
6. How much leverage do they offer?
7. Is this broker trustworthy? Do they have a history of messing with their clients?
8. Do they offer negative account balance protection ?

FX has so many brokers you are really spoiled for choice, there is absolutely zero reason to trade with an unregulated broker. I like to trade with a broker regulated in a G7 Country, this gives me peace of mind that my funds are safe, currently my broker is subject to both FCA(UK) & ASIC(Australia) regulations.

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