



INTRODUCTION BASIC FOREX TRADING

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Forex Trading - Introduction

Forex Market is an exciting place. The one good thing about entering into the forex market is that you can trade anytime as per your convenience.

The global Foreign exchange market ('FX', 'Forex' or 'FOREX') is the largest market in the world as measured by the daily turnover with more than US\$5 trillion a day eclipsing the combined turnover of the world's stock and bond markets. The forex market measuring a propelling turnover is one of the many reasons why so many private investors and individual traders have entered the market. The investors have discovered several advantages many of which are not available in the other markets.

What is Forex?

Forex (in simple terms, currency) is also called the foreign exchange, FX, or currency trading. It is a decentralized global market where all the world's currencies trade with each other. It is the largest liquid market in the world.

The liquidity (more buyers and sellers) and competitive pricing (the spread is very small between bid and ask price) available in this market are great. With the irregularity in the performance in other markets, the growth of forex trading, investing and management is in upward trajectory.

Why Trade Forex?

So, why trade Forex? There are many reasons to trade in Forex. If we ask four different people, you might get more than four different answers. Primarily, making money is the most frequently cited reason for why trade Forex.

Let us now consider the following reasons why so many people are choosing forex market

Forex market never sleeps

The Forex market works 24 hours and 5-1/2 days a week. Because governments, corporates and private individual who require currency exchange services are spread around the world, so trading on the forex market never stops. Activity on the forex market follows the sun around the world, so right from the Monday morning opening in Australia to the afternoon close in New York. At any point of the day you can find an active pair to trade.

Long or Short

A trader in forex can trade both ways. It means a forex trader can play the market and make profits irrespective of whether market is going up, down or is in tight range. So irrespective of the event that has triggered the movement – forex traders do not care.

Low transaction cost

Most forex accounts trade with little or no commission and there is no exchange or data license fees. Generally, the retail transaction fee (the bid/ask spread) is typically less than 0.1% under normal market conditions. With larger dealers (where volumes are huge), the spread could be as low as 0.05%. Leverage plays a crucial role here.

Leverage

Leverage is the mechanism by which a trader can take position much larger than the initial investment. Leverage is one more reason why you should trade in forex. Few currency traders realize the advantage of financial leverage available to them. For example, if you are trading in equity market, the maximum leverage a stock broker is offered is 1:2 but in case of forex market, you will get a leverage up to 1:50 and in many parts of the world even higher leverage is available. For this reason, it is not hard to see that why forex trading is so popular.

High leverage allows a trader with small investment to trade higher volumes of currencies and thus provide the opportunity to make significant profits from the small movement in the market. However, if the market is against your assumption you might lose significant amount too. Therefore, like any other market, it is a two-way sword.

High Liquidity

The size of forex market is enormous and liquid by nature. High liquidity means a trader can trade with any type of currency. Timing is not a constraint as well; trading can be done as per your convenience. The buyers and sellers across the world accept different types of currencies. In addition, forex market is active 24 hours a day and is closed only on the weekends.

Accessibility

Getting started as a currency trader would not cost a ton of money especially when compared to trading stocks, option, or future market. We have online forex brokers offering “mini” or “micro” trading accounts that let you open a trading account with a minimum account deposit of \$25. This allows an average individual with very less trading capital to open a forex trading account.

Who Trades Forex?

The forex market is enormous in size and is the largest market with millions of participants. Hundreds of thousands of individuals (like us), money exchangers, to banks, to hedge fund managers everybody participates in the forex market.

When can you trade forex?

Forex market is open 24 hours a day and 5 days a week. However, it does not mean it is always active. Let us check what a 24-hour day in the forex world looks like.

The forex market is divided into four major trading sessions: the Sydney session, the Tokyo session, the London session, and the New York session.

Forex Market Hours

The following table shows the opening and closing time of each session.

Summer Session (Around April – October)

TIME ZONE	EDT	GMT
Sydney open	6:00 PM	10:00 PM
Sydney close	3:00 AM	07:00 AM
Tokyo Open	7:00 PM	11:00 PM
Tokyo Close	4:00 AM	08:00 AM
London Open	03:00 AM	07:00 AM
London Close	12:00 PM	04:00 PM
New York Open	08:00 AM	12:00 PM
New York Close	05:00 PM	09:00 PM

Winter (Around October – April)

TIME ZONE	EST	GMT
Sydney Open	04:00 PM	09:00 PM
Sydney Close	01:00 AM	06:00 AM
Tokyo Open	06:00 PM	11:00 PM
Tokyo Close	03:00 AM	08:00 AM
London Open	03:00 AM	08:00 AM
London Close	12:00 PM	05:00 PM
New York Open	08:00 AM	01:00 PM
New York Close	05:00 PM	10:00 PM

Note: The actual opening and closing timing of forex market depends on local business hours.

We can see in the above chart that in between different forex trading session (region wise), there is a period of time where two sessions (region time) are open at the same time.

There is always more volume of trade when two markets (in different regions) are open at the same time.

Forex Trading – The structure of the forex market

In this chapter, we will learn about the structure of the forex market. The structure of a typical stock market is as shown below:



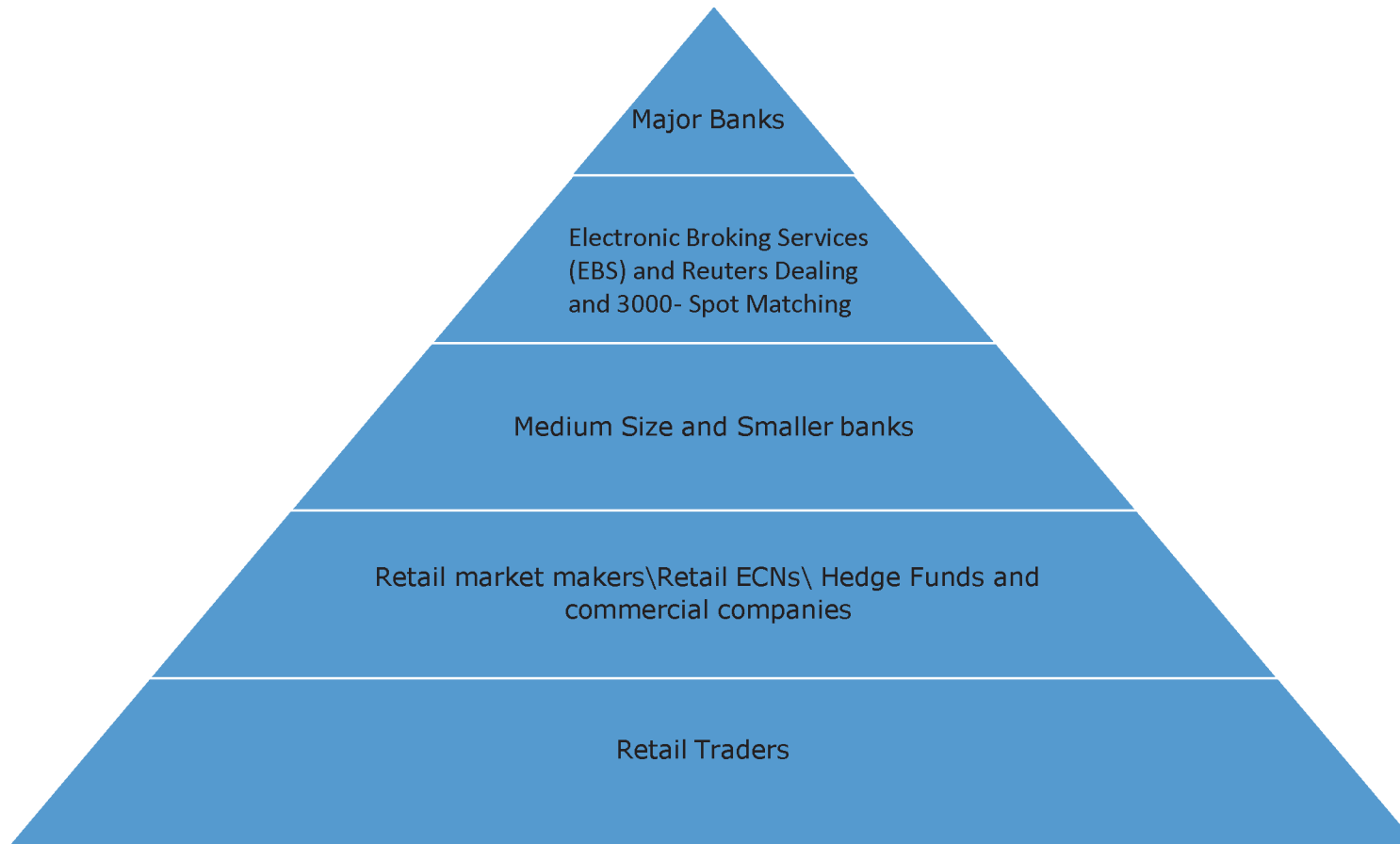
But the structure of the forex market is rather unique because major volumes of transactions are done in Over The Counter (OTC) market which is independent of any centralized system (exchange) as in the case of stock markets.

The participants in this market are:

- Central Banks
- Major commercial banks
- Investment banks
- Corporations for international business transactions
- Hedge funds
- Speculators
- Pension and mutual funds
- Insurance companies
- Forex brokers

Hierarchy of Participants

The forex market structure may be represented as shown below:



Market Participants

In the above diagram, we can see that the major banks are the prominent players and smaller or medium sized banks make up the interbank market. The participants of this market trade either directly with each other or electronically through the Electronic Brokering Services (EBS) or the Reuters Dealing 3000-Spot Matching.

The competition between the two companies – The EBS and the Reuters 3000-Spot Matching in forex market is like Pepsi and Coke in the consumer market.

Some of the largest banks like HSBC, Citigroup, RBS, Deutsche Bank, BNP Paribas, Barclays Bank among others determine the FX rates through their operations. These large banks are the key players for global FX transactions. The banks have the true overall picture of the demand and supply in the overall market and have the current scenario of any current. The size of their operations effectively lay down the bid-ask spread that trickles down to the lower end of the pyramid.

The next tier of participants are the non-bank providers such as retail market makers, brokers, ECNs, hedge funds, pension and mutual funds, corporations, etc. Hedge funds and technology companies have taken significant chunk of share in retail FX but very less foothold in corporate FX business. They access the FX market through banks, which are also known as liquidity providers. The corporations are very important players as they are constantly buying and selling FX for their cross-border (market) purchases or sales of raw or finished products. Mergers and acquisitions (M&A) also create significant demand and supply of currencies.

Sometimes, governments and centralized banks like the RBI (in India) also intervene in the Foreign Exchange market to stop too much volatility in the currency market. For instance, to support the pricing of rupees, the government and centralized banks buy rupees from the market and sell in different currencies such as dollars; conversely, to reduce the value of Indian rupees, they sell rupees and buy foreign currency (dollars).

The speculators and retail traders that come at the bottom of the pyramid pay the largest spread, because their trades effectively get executed through two layers. The primary purpose of these players is to make money trading the fluctuations in the currency prices. With the advancement of technology and internet, even a small trader can participate in this huge forex market.

Currency pair

If you are new to the forex market and have just started trading Forex online, you may find yourself overwhelmed and confused both at a time by the huge number of available currency pairs inside your terminal (like the MetaTrader4, etc.). So what are the best currency pairs to trade? The answer is not that straightforward as it varies with each trader and its terminal window or with what exchange (or OTC market) he is trading. Instead, you need to take the time to analyse different pairs of currencies against your own strategy to determine the best forex pairs to trade on your accounts.

The trade in Forex market occurs between two currencies, because one currency is being bought (buyer/bid) and another sold (seller/ask) at the same time. There is an international code that specifies the setup of currency pairs we can trade. For example, a quote of EUR/USD 1.25 means that one Euro is worth \$1.25. Here, the base currency is the Euro (EUR), and the counter currency is the US dollar.

Commonly Used Currency Pair

In this section, we will learn about a few commonly used currency pair.

The most traded, dominant and strongest currency is the US dollar. The primary reason for this is the size of the US economy, which is the world's largest. The US dollar is the preferred base or reference currency in most of the currency exchange transactions worldwide. Below are some of the most traded (high liquidity) currency pairs in the global forex market. These currencies are part of most of the foreign exchange transactions. However, this is not necessarily the best currency to trade for every trader, as this (which currency pair to choose) depends on multiple factors:

- EUR/USD (Euro – US Dollar)
- GBP/USD (British Pound – US Dollar)
- USD/JPY (US Dollar – Japanese Yen)
- USD/CHF (US Dollar – Swiss Franc)
- EUR/JPY (Euro – Japanese Yen)
- USD/CAD (US Dollar – Canadian Dollar)
- AUD/USD (Australian Dollar – US Dollar)

As prices of these major currencies keep changing and so do the values of the currency pairs change. This leads to a change in trade volumes between two countries. These pairs also represent countries that have financial power and are traded heavily worldwide. The trading of these currencies makes them volatile during the day and the spread tends to be lower.

EUR/USD Currency Pair

The EUR/USD currency pair is the most popular currency pair and has the lowest spread among modern world forex brokers. This is also the most traded currency pair in the world. About 1/3rd of all the trade in the market is done in this currency pair. Another important point is that this forex pair is not too volatile. Therefore, if you do not have that much risk appetite you can consider this currency pair to trade.

Currencies

EUR / USD 3:30 PM UTC	1.19 -0.0071 (0.60%) ↓
USD / JPY 3:30 PM UTC	109.30 +0.36 (0.33%) ↑
GBP / USD 3:29 PM UTC	1.35 -0.0053 (0.39%) ↓
USD / CAD 3:31 PM UTC	1.30 +0.010 (0.78%) ↑
USD / HKD 3:30 PM UTC	7.85 -0.00080 (0.010%) ↓
USD / CNY 3:30 PM UTC	6.37 +0.0036 (0.057%) ↑
AUD / USD 3:29 PM UTC	0.74 -0.0073 (0.97%) ↓

The following diagram shows some of the major currency pairs and their values.

The Bid-Ask Spread

The spread is the difference between the bid price and the ask price. The bid price is the rate at which you can sell a currency pair and the ask price is the rate at which you can buy a currency pair (EUR/USD).

Whenever you try to trade any currency pair, you will notice that there are two prices shown, as shown in the image below:

The following image shows the spread between USD and INR (US Dollar – Indian Rupees) pair.

U S Dollar-Indian Rupee - USDINR | Option Chain | Currency Watch

Index Derivatives Derivatives
 Stock Derivatives
 Currency

Instrument Type: Currency Futu
 Symbol: USDINR
 Expiry Date: 29MAY2018
 Option Type: Select
 Strike Price: Select...
 Get Data

67.2625 ▲ 0.20 0.29%	Prev. Close 67.0675	Open 67.1925	High 67.3050	Low 66.9500
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Fundamentals

	Print
RBI Reference Rates	66.7681
No. of Trades	21,631
Traded Volume (contracts)	10,86,313
Traded Value * (lacs)	729566.10
VWAP	67.2156
Open Interest	27,27,878
Change in Open Interest	81,779
% Change in Open Interest	3.09

Historical Data

Order Book		Intra-day	
Buy Qty.	Buy Price	Sell Price	Sell Qty.
3	67.2600	67.2625	696
422	67.2575	67.2650	1,181
1,080	67.2550	67.2675	890
1,610	67.2525	67.2700	390
1,468	67.2500	67.2725	1,132
696,246	Total Quantity		192,991

(Source: Above data is taken from nseindia.com)

The lower price (67.2600 in our example) is called the "Bid" and it is the price at your broker (through which you're trading) is willing to pay for buying the base currency (USD in this example) in exchange for the counter currency (INR in our case). Inversely, if you want to open a short trade (sell), you will do so at the price of 67.2625 in our example. The higher price (67.2625) is called the 'Ask' price and it is the price at which the broker is willing to sell you the base currency (USD) against the counter currency (INR).

What are Bullish and Bearish Markets?

The term "bull" (bullish) and "bear" (bearish) are often used to describe how the overall financial market is performing in general – whether there is an appreciation or depreciation. Simply put, a bull (bullish) market is used to describe conditions where market is rising and a bear (bearish) market is the one where market is going down. It is not, a single day which describes if the market is in bullish or bearish form; it is a couple of weeks or months which tell us if the market is in the bull(bullish) or the bear(bearish) grip.

What happens in a Bull Market?

In a bull market, the confidence of the investor or the traders is high. There is optimism and positive expectations that good results will continue. So, in all, bull market occurs when the economy is performing well – unemployment is low, GDP is high and stocks markets are rising.

The bull market is generally related with the equity (stock) market, but it applies to all financial markets like currencies, bonds, commodities, etc. Therefore, during a bull market everything in the economy looks great - the GDP is growing, there is less unemployment, the equity prices are rising, etc.

All this leads to rises not only in stock market but also in FX currencies such as Australian Dollar (AUD), New Zealand Dollar (NZD), Canadian Dollar (CAD) and emerging market currencies. Conversely, the bull market generally leads to a decline in safe-haven currencies such as US dollar, the Japanese yen or the Swiss franc (CHF).

Why does it Matter to You?

Forex trading is always done in pairs, where if one currency is weakening the other is strengthening. As you can trade both ways mean you can take a long (buy) or short (sell) view in either currency pair, thereby allowing you to take advantage of rising and falling markets.

In forex market, bull and bear trends also determine which currency is stronger and which is not. By correctly understanding the market trends, a trader can make proper decisions of how to manage risk and gain a better understanding of when it is best to enter and exit from your trades.

What happens in a Bear Market?

A bear market denotes a negative trend in the market as the investor sells riskier assets such as stock and less-liquid currencies such as those from emerging markets. The chances of loss are far greater because prices are continually losing value. Investor or traders are better off short-selling or moving to safer investments like gold or fixed-income securities.

In a bearish market, investor generally moves to safe-haven currencies like Japanese Yen (JPY) and US Dollar (USD) and sold off riskier instruments.

Why does it Matter to You?

Because a trader can earn great profit during bull and bear market considering you are trading with the trend. As forex trading is always done in pairs, buy the strength and sell the weak should be your trade.

What is Lot size?

Let us now learn what a lot size is.

A lot is a unit to measure the amount of the deal. Your value of your trade always corresponds to an integer number of lots (lot size * number of lots).

Trading with the proper position or lot size on each trade is key to successful forex trading. The position size refers to how many lots (micro, mini or standard) you take on a particular trade.

The standard size for a lot is 100,000 units of base currency in a forex trade, and now we have mini, micro and nano lot sizes that are 10,000, 1,000 and 100 units respectively.

What is long in forex trade?

Whenever you purchase (buy) a currency pair, it is called going long. When a currency pair is long, the first currency is purchased (indicating, you are bullish) while the second is sold short (indicating, you are bearish).

For example, if you are purchasing a EUR/INR currency pair, you expect that the price of Euro will go high and the price of Indian rupees (INR) will go down.

What is Short in forex trade?

When you go short on a forex, the first currency is sold while the second currency is bought. To go short on a currency means you sell it hoping that its prices will decline in future.

In forex trade, whether you are making "long" (buying a currency pair) or "short" (selling a currency pair) trades, you are always long on one currency and short on another. Therefore, if you sell, or go short on USD/INR, then you are long on INR and short on USD. It means you expect the prices of INR (Indian rupees) will rise and the price of the USD (US dollar) will fall.

What are pending orders in forex trading?

A pending order in any trade is an order that was not yet executed thus not yet becoming a trade. Generally, while trading we place the order with a limit, means our order (pending trade) will not get executed if the price of a financial instrument does not reach a certain point.

A large section of traders follows technical analysis, so if anyone (traders or investors) wants to place an order at the support or resistance level but currently market is not on these levels, then he/she can place pending order rather than waiting. Pending order will automatically get executed once price reaches to the pending order position. The following are the four types of pending order:

Buy Limit

A pending order to buy a currency at a lower price (whatever price trader wants to buy) than the current one.

Buy Stop

A pending order to buy a currency at a higher price (whatever price trader wants to execute) than the current one.

Sell Limit

A pending order to sell a currency pair at a higher price (whatever price trader wants to sell) than the current price.

Sell Stop

A pending order to sell a currency pair at a lower price (buy high, sell low).

What is Leverage and Margin?

In this chapter, we will learn about leverage and margin and how these influence the financial market.

What is Leverage?

Forex trading provides one of the highest leverage in the financial market. Leverage means having the ability to control a large amount of money using very little amount of your own money and borrowing the rest.

For example, to trade a \$10,000 position (traded value of security); your broker wants \$100 from your account. Your leverage, which is expressed in ratios, is now 100:1. In short, with mere \$100, you are controlling \$10,000.

Therefore, if during the trade \$10,000 investment rises in value to \$10,100, it means a rise in \$100. Because you are leveraged 100:1, your actual amount invested is \$100 and your gain is \$100. This in turn your return to a groovy 100%.

In such case, the trade goes in your favor. What if, you have ended up with a -1% return (\$10,000 position). -100% return using 100:1 leverage.

Therefore, risk management of leverage position is very important for every trader or investor.

What is Margin?

Margin is the amount of money your trading account (or broker needs) should have as a "good faith deposit" to open any position with your broker.

So consider the leverage example in which we are able to take position of \$100,000 with an initial deposit amount of \$1000.

This \$1000 deposit amount is called "margin" you had to give in order to initiate a trade and use leverage.

Your broker to maintain your position uses it. The broker collects margin money from each of its client (customer) and uses this "super margin deposit" to be able to place trades within the interbank network.

Margin is expressed as a percentage of the full amount of the position. Your margin may vary from 10% to .25% margin. Based on the margin required by your broker, you can calculate the maximum leverage you can yield with your trading account.

For example, if your broker required 5% margin, you have the leverage of 20:1 and if your margin is 0.25%, you can have leverage of 400:1.

Hedging

Hedging is basically a strategy which is intended to reduce possible risks in case prices movement against your trade. We can think of it with something like "insurance policy" which protects us from particular risk (consider your trade here).

To protect against a loss from a price fluctuation in future, you usually open an offsetting position in a related security. Traders and investors usually use hedging when they are not sure which way the market will be heading. Ideally, hedging reduces risks to almost zero, and you end up paying only the broker's fee.

A trader can utilize hedging in the following two ways:

To open a position in an off-setting instrument

The offsetting instrument is a related security to your initial position. This allows you to offset some of the potential risks of your position while not depriving you of your profit potential completely. One of the classic example would be to go long say an airline company and simultaneously going long on crude oil. As these two sector are inversely related, a rise in crude oil prices will likely cause your airline long

position to suffer some losses but your crude oil long helps offset part or all of that loss. If the oil prices remain steady, you may profit from the airline long while breaking even on your oil position. If the prices of oil goes down, the oil long will give you losses but the airline stock will probably rise and mitigate some or all your losses. So hedging helps to eliminate not all but some of your risks while trading.

To buy and/or sell derivative (future/forward/option) of some sort in order to reduce your portfolio's risk as well as reward exposure, as opposed to liquidating some of your current positions. This strategy may come handy where you do not want to directly trade with your portfolio for a while due to some market risks or uncertainties, but you rather not liquidate part or all of it for other reasons. In this type of hedging, the hedge is straightforward and can be calculated precisely.

Stop Losses

A stop-loss is an order placed in your trading terminal to sell a security when it reaches a specific price. The primary goal of a stop loss is to mitigate an investor's loss on a position in a security (Equity, FX, etc.). It is commonly used with a long position but can be applied and is equally profitable for a short position. It comes very handy when you are not able to watch the position.

Stop-losses in Forex is very important for many reasons. One of the main reason that stands out is no one can predict the future of the forex market every time correctly. The future prices are unknown to the market and every trade entered is a risk.

Forex traders can set stops at one fixed price with an expectation of allocating the stop- loss and wait until the trade hits the stop or limit price.

Stop-loss not only helps you in reducing your loss (in case trade goes against your bet) but also helps in protecting your profit (in case trade goes with the trend). For example, the current USD/INR rate is 66.25 and there is an announcement by the US federal chairperson on whether there will be a rate hike or not. You expect there will be a lot of volatility and USD will rise. Therefore, you buy the future of USD/INR at 66.25. Announcement comes and USD starts falling and suppose you have put the stop-loss at

66.05 and USD falls to 65.5; thus, avoiding you from further loss (stop-loss hit at 66.05). Inversely in case USD starts climbing after the announcement, and USD/INR hit 67.25. To protect your profit you can set stop-loss at 67.05(assume). If your stop-loss hit at 67.05(assume), you make profit else, you can increase your stop-loss and make more profit until your stop-losses hit.

Forex Trading – Major currencies and trade systems

The forex currencies of a country are influenced by a series of macro-economic conditions as well as the world's economic situation. Macro indicators like Economic indicators (GDP growth, imports/exports), social factors (the unemployment rate, country infra-structure or real estate market conditions) and the country central bank's (like RBI in india) policies are the key factors that determine the value of a currency on the foreign exchange market.

Major Currencies

In this section, we will learn about the distinct features of six major currencies.

The US Dollar

The US Dollar dominates the world foreign exchange market heavily. The US Dollar is the base or universal currency to evaluate any other currency traded on forex. Almost all currencies are generally quoted in US dollar terms.

The US dollar currently represents about 86% of all foreign exchange market transactions. Most commodities (metals, oil etc.) are traded with prices denominated in US Dollars; as a result, any fluctuations in supply and demand of these commodities have direct impact on the value of US Dollar. This happened in 2008 financial crisis when oil prices collapsed and the EUR/USD climbed to 1.60.

As US dollar is considered as the safe-haven currency. Therefore, investors move towards the dollar when economic conditions deteriorate.

The Euro (EUR)

The Euro is the second most dominating currency in the forex market. Like the US Dollar, the Euro also has a strong international acceptance streaming from the members of the European Monetary Union.

The Euro is used by 18 member countries of the European Union and is currently accounted for almost 37% of all forex transactions.

The main factors that influence the acceptance of Euro's prices are often based on well-established economies (developed countries) that use the common currency, such as France and Germany. Euro prices depend on key countries (like Germany) Consumer Price Inflation (CPI), the European Central Bank, unemployment rate, and exports data.

The Euro is the common currency of all the European countries and there is a difference between these countries' economies, as was highlighted during the 2011 debt crisis. This restricts the dominance of Euro in the global forex market. In the event of problems, EU leaders have a hard time finding common solutions that are beneficial to both the large and small economies.

The Japanese Yen (JPY)

The Japanese yen is the most traded and dominating currency in the Asian forex market. It is the third most popular or traded currency in the forex market and represents almost

20% of the world's exchange. The natural demand to trade the Yen comes mostly from the Japanese Keiretsu, the economic and financial conglomerates. The Japanese stock market, .i.e., the Nikkei index and real estate market correlate with the volatility of the Japanese yen (JPY).

Because the Japanese economy is mostly an industrial exports economy, the Japanese currency (JPY) among traders and investors is considered as a safe-haven currency in periods when risk aversion hits the market. Low interest rates in Japan allows traders to borrow at low cost and invest in other countries.

The JPY's currency risks are related to the constant devaluation of the currency and the interventions of the country's central bank. Because Japan is an export oriented economy, the central bank is constantly trying to weaken its currency.

The British Pound (GBP)

The British Pound is the UK's currency. Until the end of World War II, the pound continued to have the same dominance in forex market what is US dollar today and was the currency of reference. The currency (GBP) is heavily traded against the euro and the US dollar but has less presence against other currencies.

The British Pound (GBP) is the fourth most traded currency internationally and about 17% of all transaction is done through GBP in global forex market. Because London is considered as the forex market hub globally, 34% of all forex transaction pass through London City.

The fundamental factors that affect the pound are as complex and varied as the British economy and its influence on the world. Inflation, country GDP and the housing market influence the pound value.

Forex traders sometimes use the pound as an alternative to the euro especially when the European Union's problems become too bad.

The Swiss Franc (CHF)

The Swiss Franc is the currency and legal tender of Switzerland. The currency code for Franc is CHF and the most popular Switzerland franc exchange rate is the CHF/EUR pair. It is also, the only currency of a major European country that neither belongs to the European Union nor to the G-7 countries. Though the size of the Swiss economy is relatively small, the Swiss franc is one of the four major currencies traded in the forex market, closely resembling the strength and quality of the Swiss economy and finance.

The CHF is also considered as the safe-haven currency and investors move towards it during periods of risk aversion: the Swiss economy and its foreign reserves mainly gold (7th largest reserve in the world) add to the currency's credibility.

The Canadian Dollar (CAD)

The CAD is a commodity driven currency. This is because the Canadian economy is export- oriented and the main product of export is crude oil. Therefore, the Canadian Dollar prices are influenced by the price of crude oil.

Global economic growth and technological progress help to make the CAD attractive to investors.

Different Trade systems on Forex

There are different ways in which trading is done in the global forex market. The commonly followed trading systems in the forex market are described below:

Trading with brokers

The foreign exchange broker or the forex broker also known as the currency-trading broker unlike the equity or commodity brokers does not hold positions. The main role of these brokers is to serve banks. They act as intermediaries to buy and sell currencies at commissioned rates.

Before the dawn of Internet, a majority of the FX brokers executed orders via phone using an open box system. There was a microphone in the broker desk that continuously transmitted all that he communicated on the direct phone lines to the speaker's boxes in the banks. This way, banks also received all the business orders.

In an open box system used by brokers, a trader is able to hear all the prices quoted; whether the bid was executed or the offer (ask) taken; and the price that followed. What is hidden from the trader is the amounts of particular bids and offers and the names of the banks showing the prices. The prices were confidential, and the buyers and sellers were anonymous.

In this age of Internet, many brokers have allowed clients to access their accounts and trade through electronic platform (mostly through their proprietary software) and computer applications.

Direct Dealing

Direct dealing is based on the economy of mutuality. All participants in the currency market

- a bank, establishing a price, thinks that the other bank that has turned to it will reply with mutuality, establishing its own price, when they turn to the bank. Direct dealing provides freedom of actions than the dealing of the broker market. Sometimes traders take advantage of this characteristic.

Direct dealing previously took place over the phone. This gave way to mistakes which could not be identified and rectified. The mid-1980s witnessed a transition from direct dealing to dealing systems.

Dealing systems are computers that link the contributing banks around the world. Each computer is connected with a terminal. To connect to a bank through dealing system is much faster than connecting through a phone. The dealing systems are getting more secure by each day. The performance of dealing system is characterized by its speed, safety and reliability. The trader is in permanent visual contact with the information changing on its terminal/monitor. It is more comfortable with this information rather than to be heard during the switches, during the conversations.

Many banks use a combination of brokers and direct dealing systems. Both these methods can be used by the same bank but not in the same market.

Matching Systems

Matching systems are quite different when compared with dealing systems. Matching systems are anonymous and individual traders deal against the rest of the market, similar to dealing in the broker's market but unlike dealing systems where trading is not anonymous and is conducted on a one-to-one basis. Unlike the broker's market, there are no individual to bring the prices to the market, and liquidity is limited at times.

The different characteristics of matching systems are – speed, safety and reliability like the dealing system we have. One advantage in matching system is that credit lines are automatically managed by the systems.

In the interbank market, traders deal directly with dealing systems, matching systems and brokers in a complementary fashion.

Forex Trading – Types of Market analysis

In this chapter, we will learn about the different types of market analysis. There are three types of analysis used for the market movements forecasting:

- **Fundamental Analysis:** This is the analysis of social, economic and political factors that affect currency supply and demand.
- **Technical Analysis:** This is the study of price and volume movement.
- **Sentiment Analysis:** Apart from mini and micro analysis of data, this is the analysis of the mindsets and sentiments of traders and investors.

Fundamental Analysis and Technical Analysis (FA and TA) go hand-in-hand in guiding the forex trader through the way the market (prices) may go under the ever-changing market conditions.

Fundamental Analysis

Fundamental analysis is analyzing the currency price forming, basic economical and other factors influencing the exchange rate of foreign currency.

It is the analysis of economic and political information with the hope of predicting future currency price movements.

Fundamental analysis helps in forecasting future prices of various foreign currencies. Forecasting of prices is based on a number of key economic factors and indicators that determine the strength of a country's economy. The factors may also include various geo-political aspects that may impact the price movement of a currency pair.

This analysis is not used to get the specific numbers for the exchange rates of various currencies. Instead, it helps in determining the trend of the forex spot market over a certain period.

If the fundamental analysis hints at a positive outlook for a particular currency pair, it indicates that the price of that pair would experience an upward trajectory movement in the near future. A negative outlook indicates a declining price movement of currency pair in coming future. A neutral instance on currency pair indicates a flat (not much +ve or -ve side movement) movement in the near future.

When to use fundamental analysis for the forex market?

Whenever a forex trader receives information about the state of a country, he conducts a fundamental analysis to gauge the impact of this on various currency pairs.

Forex traders and investors always look into reports (fundamental analysis reports) based on critical economic data before trading (particular currency pair) on forex market. These reports (FA) also enable them to minimize the risk factors involved in executing forex transactions.

The Fundamental Analysis report for any market (equity, commodity, FX etc.) helps in decision-making over medium to long term exchange rate prediction (in case of FX market). On the other hand, Technical Analysis provides information for short-term predictions.

The market's momentum can easily reverse or an extreme volatility can be seen in a matter of minutes after an important announcement or press release is made by the central bank. Information related to the status of the local and global economies can have huge impact on the direction in which the forex market trends.

Key factors influencing fundamental analysis

Let us now learn about the key factors that influence fundamental analysis. The factors are described below in brief:

Interest Rates

The interest rates set by the central bank is one of the most important factors in deciding the price movement of currency pairs. A high interest rate increases the attractiveness of a country's currency and also attracts forex investors towards buying.

GDP Growth

A high GDP growth rate signifies an increase in the total wealth of the country. This points towards the strengthening of the country's currency and its value rises relative to other foreign currencies.

Industrial Production

A high industrial growth in any country signifies a robust country economy. A country with robust economy encourages forex traders to invest in country forex currency.

Consumer Price Index (CPI)

The Consumer Price Index (CPI) is directly proportional to the prices of goods and services in the country. If the CPI index is too high (above the central bank benchmark of CPI), there is a high probability that central bank is most likely to lower interest rates to bring down the rate of inflation and stabilize the growth rate for the country's economy.

Retail Sales

A country's retail sales data gives an accurate picture of how people are spending (people income level) and the health of its economy at the lowest level. A strong retail sales figure shows that the domestic economy of a country is in strong shape; it points towards positive growth rates in the future.

Apart from these above points, the traders and investors also look into other factors of fundamental analysis like employment statistics, national debt levels, supply and demand balance, monetary policy, political situation, trade deficit, commodity prices, housing prices and capital market growth.

Technical Analysis

Technical analysis helps in the prediction of future market movements (that is, changing in currencies prices, volumes and open interests) based on the information obtained from the past.

There are different kinds of charts that help as tools for technical analysis. These charts represent the price movements of currencies over a certain period preceding exchange deals, as well as technical indicators. The technical indicators are obtained through mathematical processing of averaged and other characteristics of price movements.

Technical Analysis (TA) is based on the concept that a person can look at historical price movements (for example currency) and determine the current trading conditions and potential price movement.

Dow Theory for Technical Analysis

The fundamental principles of technical analysis are based on the Dow Theory with the following main assumptions:

Price discounts everything

Price is a comprehensive reflection of all the market forces. At any point of time, all market information and forces are reflected in the currency price ("The Market knows everything").

Prices usually move in the direction of the trend

Price movements are usually trend followers. There is a very common saying among traders – “Trend is your friend”.

Trends are classified as –

- Up trends (Bullish pattern)
- Down trends (Bearish pattern)
- Flat trends (sideways pattern)

Price movements are historically repetitive. This results in similar behavior of patterns on the charts.

Sentimental Analysis

The participants in every market, the traders and the investors have their own opinion of why the market is acting the way it does and whether to trade in the direction of market (towards market trends) or go against it (taking contrary bet).

The traders and investors come with their own thoughts and opinions on the market. These thoughts and opinions depend on the position of the traders and investors. This further helps in the overall sentiment of the market regardless of what information is out there.

Because the retail traders are very small participants in the overall forex market, so no matter how strongly you feel about a certain trade (belief), you cannot move the forex markets in your favour.

Even if you (retail trader) truly believe that the Dollar is going to go up, but everyone else (big players) is bearish on it, there is nothing much you can do about it (unless you are one of the big investment banks like – Goldman Sachs or some ultra-rich individual like Warren Buffet).

It is the trader’s view on how he is feeling about the market, whether it is bullish or bearish. Depending on this, a trader further decides how to play the perception of market sentiment into trading strategy.

What type of analysis is better?

Forex trading is all about trading based on a strategy. Forex trading strategies help you gain an insight of the market movements and make moves accordingly. We have already studied that there are three types of analysis methods.

- Technical analysis
- Fundamental analysis
- Sentiment analysis

Each strategy holds equal importance, and neither can be singled out. Many traders and investors prefer the use of a single analysis method to evaluate long-term investments or to gain short-term profit. A combination of fundamental, technical, and sentimental analysis is the most beneficial. Each analysis technique requires the support of another to give us sufficient data on the Forex market.

These three strategies go hand-in-hand to help you come up with good forex trade ideas. All the historical price action (for technical analysis) and economic figures (for fundamental analysis) are there – all you have to do is put on your thinking cap (for sentimental analysis) and put those analytical skills to the test.

In order to become a professional forex trader, you will need to know how to effectively use these three types of forex market analysis methods.

Forex Trading – Benefits of trading forex

There are many advantages of trading forex over trading in other market instruments such as equity and derivative. The benefits of trading forex have the following benefits:

Low cost

If we consider trading forex market spot, normally there is no clearing fees, no exchange fees, no government taxes, no brokerage fees, and no commissions. Generally, retail brokers make their profits from the Bid/Ask Spread, which is apparently very transparent to users.

No middlemen

In spot forex trading, there are no middlemen. It allows you to trade directly with the market accountable for the pricing of the currency pair (EUR/INR).

No fixed lot sizes

In the spot forex market, there is no fixed lot size for trading, though there is a fixed lot size which you need to trade, if you are trading in forex future or option market. This is one of the big advantages of forex trading. Generally, brokers provide the option to buy in multiple lot sizes as per your client requirement or convenience. Lot sizes differ broker to broker - standard lot, mini lot, micro lot or even nano lots. This enables you to start trading from as low as \$50.

Low transaction costs

The retail transaction cost (bid/ask spread) is usually as low as 0.1% and for bigger dealers, this could be as low as 0.07%.

No one can corner the market

The foreign exchange market is large and has many participants, and no single participant (not even a central bank) can control the market price for a prolonged time period. Therefore, the chances of sudden extreme volatility is very rare.

24-hours open market

We do not have to wait for the opening bell to ring to start trading in forex. The forex market starts, from the Monday morning opening of the Sydney session to the afternoon close session of New York session. This allows us to trade anytime we prefer without giving much attention on what time it is.

Use of Leverage and Margin

This is one of the factors, which draws more and more traders towards forex trading. Forex brokers permit traders to trade the market by using leverage and with low margin, which gives the ability to trade with more money than what is available in your account. This allows traders with less amount to trade with much higher value of trade. For example, a forex broker may allow you the margin of 50 to 100 times your invested money. Therefore, if you have \$100 in your account, you can take position from \$5000 to \$10000 that in turn can provide you bigger returns if the trade is in your favor. Inversely, always be cautious while taking very-high leverage without risk management; especially if you are a beginner, as this may wipe-out your entire amount within a couple of minutes.

Very High Liquidity

Because the size of forex market is huge, it is extremely liquid in nature. This allows you to buy or sell currency any time you want under normal market conditions. There is always someone who is willing to accept the other side of your trade.

Forex Trading – Fundamental Market forces

Any news and information regarding the country's economy can have a direct impact on the direction the country's currency is heading towards; just as how the current events and financial news affect the stock prices.

Several factors prove helpful in building long-term strength or weakness of the major currencies and will have a direct impact on you as a forex trader.

Economic Growth and Outlook

Countries with strong economic growth will surely attract foreign investors and thereby strong currency value. If the economic growth and outlook is positive, it indicates there is low unemployment rate, which in turn means higher wages to the people. Higher wages means people have more spending power, which in turn indicates higher consumption of goods and services. Thereby, this propels the economic growth of the country and there is an increase in the currency prices.

Inversely, if the economic growth and outlook of a country is weak, it indicates the unemployment rate is high. This shows that the consumers do not have the spending power; there are not too many business setups. The government (central bank) is the only entity that is spending. This leads to a decrease in the currency price.

Therefore, the positive and negative economic outlook will have direct impact on the currency markets.

Capital Flows

All thanks to globalization and technological advances which have kind of provided wings to the market participant to invest or spend virtually anywhere in the world.

Capital flows means the amount of capital or money flowing in or out of a country or economy because of capital investment via purchasing or

selling.

We can check how many foreign investors have invested in our country by looking at the capital flow balance, which can be positive or negative.

When a country has positive capital flow balance, it indicates more people have invested in the country than investments heading out of the country. While a negative capital flow balance indicates investments leaving the country is much more than investment coming in.

A higher capital flow means more foreign buyers have invested, which in turn increases the currency prices (as investors want to buy your currency and sell their own).

Consider an example of USDINR currency pair - if on one month, capital flow is very large, directly it indicates that more foreign buyers are keen on investing in our home country. For this, they need local currency. Therefore, the demand of INR will increase and the supply of foreign currency (USD or Euro) will increase. The decrease in the price of USDINR depends on what the overall capital balance is.

In simple terms, if the supply is high (sellers are more) for a currency (or demand is weak), the currency tends to lose value (buyer is less).

Trade Flows and Trade Balance

The Export and Import of goods from one country to another is a continuous process.

There are exporting countries, which sell their own goods to other countries (importing countries) that are keen on buying the goods. Simultaneously, the exporting country becomes an importing country when it in turn buys something from another country.

The buying and selling of goods is accompanied by the exchange of currencies, which in turn changes the flow of currency, depending on how much we export (value) and import (value).

The trade balance is a measure to calculate the ratio of exports to imports for a given economy.

- If the export bills of a country are higher than our import bills, we have trade surplus and the trade balance is positive.
 - $\text{export bills} > \text{import bills} = \text{Trade surplus} = \text{positive (+) trade balance}$

- If the import bills of a country are higher than our export bills, we have trade deficit situation, and the trade balance is negative.
 - $\text{import bills} > \text{export bills} = \text{Trade deficit} = \text{negative (-) trade balance}$

Positive trade balance (trade surplus) comes with the prospects of pushing the currency price up compared to other currencies.

The currencies of the countries with trade surplus are more in demand and tend to be valued higher than those in less demand (trade deficit countries' currencies).

The socio-political environment of a country

Foreign investors prefer to invest in countries where the government is stable, having stable laws for business. Instability in the current government or major changes in the current administration can have direct impact on the business environment, which in turn can have an impact on the country's economy. Any impact to an economy positive or negative will directly affect the exchange rates.

Forex Trading – Technical Indicators

In this chapter, we will learn about charts that act as technical indicators in forex trading.

What is a chart?

Charts are the main tools of technical analysis. In technical analysis, we use charts to plot a sequence of prices (price movements) of an asset over a certain duration. It is a graphical way of showing how the stock prices have performed in the past.

The period to represent the price movement of an asset (ex. currency) vary from minutes (30 min), hour, day, week, month or many years. It has an x-axis (horizontal axis) and a y-axis (vertical axis). On the chart, the vertical axis (y-axis) represents price and the horizontal axis (x-axis) represents the time. Thus, by plotting a currency pair price over a period of time (time frame), we end up with a pictorial representation of any asset (stock, commodity or FX) trading history.

A chart can also represent the history of the volume of trading in an asset. It can illustrate the number of shares (in case of equity) that change hands over a certain period.

Types of Charts

The asset price (stock, currency pair, commodity, etc.) charts come in many varieties. It is the choice of the individual traders or investors to choose one type over another. This decision may be based on:

- Familiarity and comfort
- Ease of use
- Underlying Purpose

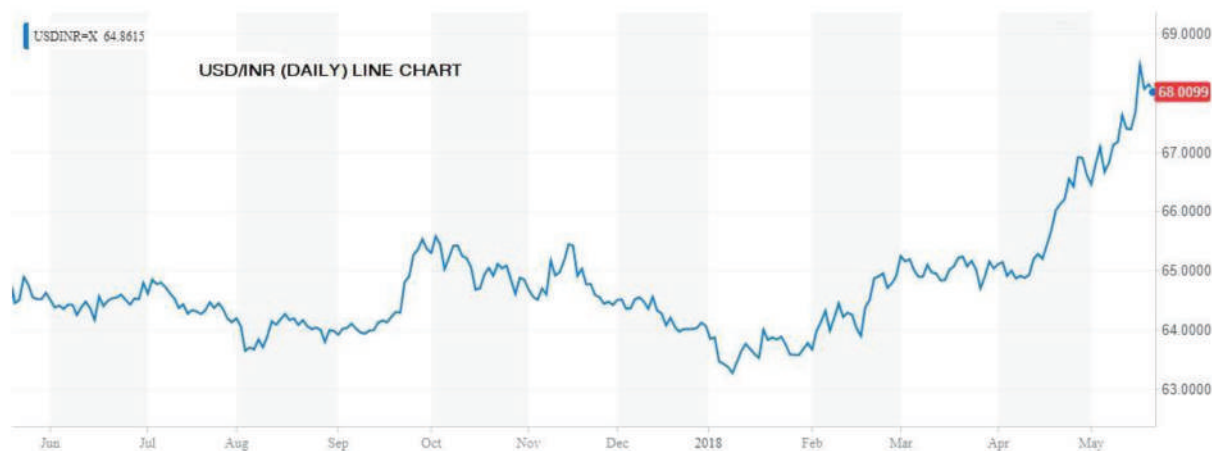
The line charts

Line charts are formed by connecting the closing price of a specific stock or market over a given period. It means, if we want to draw a line chart of a particular currency pair (USD/INR) in a 30 min time frame, we can draw the line chart by putting a straight line between prices before 30 min and current price after 30 min. The charts provide a clear visual illustration of the trend of a particular currency (or stock price) or a market's (index) movement. It is an extremely valuable analytical tool for technical analysts, traders and also investors.

Line charts are mostly used when two or more trends have to be compared. For example, comparing closing prices of two more companies (same exchange listed and from same domain) or for a currency pair (USD/INR) compared to all the other listed currency pair in the region (ex. Asia).

The line chart exhibits price information with a straight line (or lines) connecting data (price or volume) values.

Below is the line chart of USDINR of 1-year time frame.

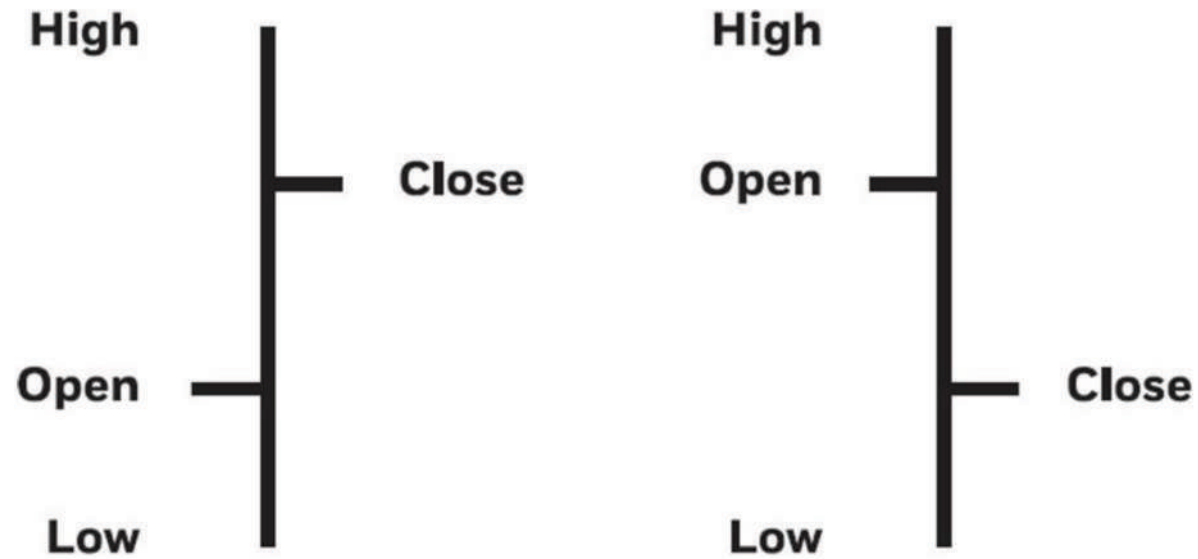


Bar Chart

Bar chart is a commonly used type of chart by technical analysts. It is called bar chart because each day's range is represented by a vertical bar.

Although daily bar charts are best known, bar charts can be created for any period – weekly, monthly and yearly for example. A bar shows the high price for the period at the top and the lowest price at the bottom of the bar. Lines on either side of the vertical bar serve to mark the opening and closing prices of an asset (stock, currency pair). A small tick on the left side of the bar shows the opening price and a tick to the right of the bar shows closing price.

Many traders work with bar charts created over a matter of minutes during a day's trading.

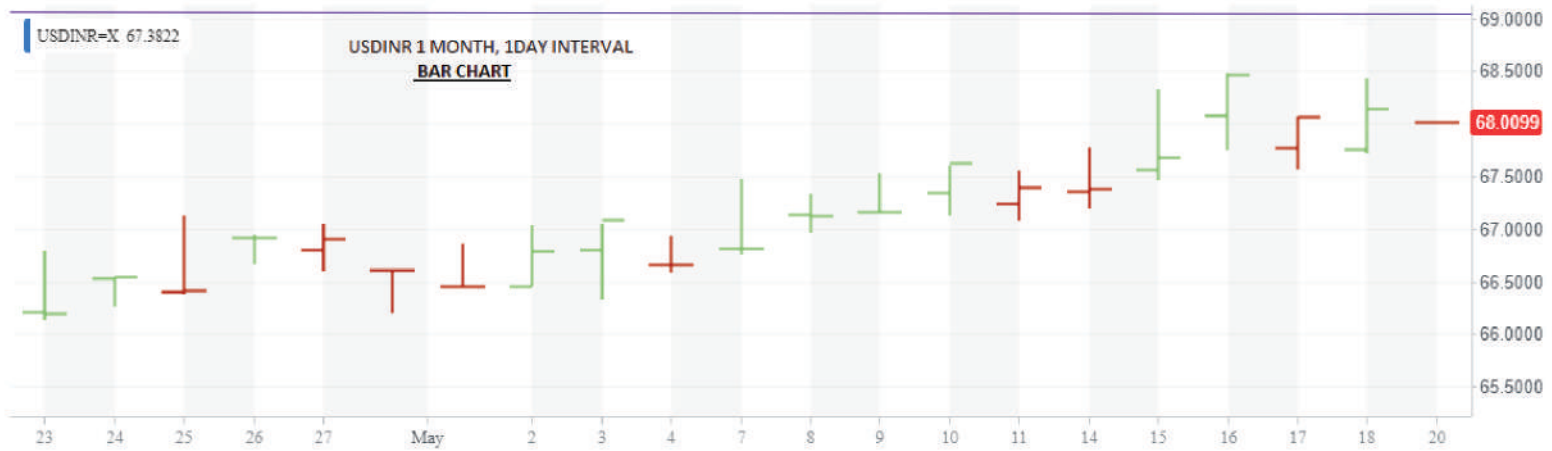


OHLC Bar
Range = High - Low

Following is a 5-Day Bar chart of USDINR in 5 minutes interval.

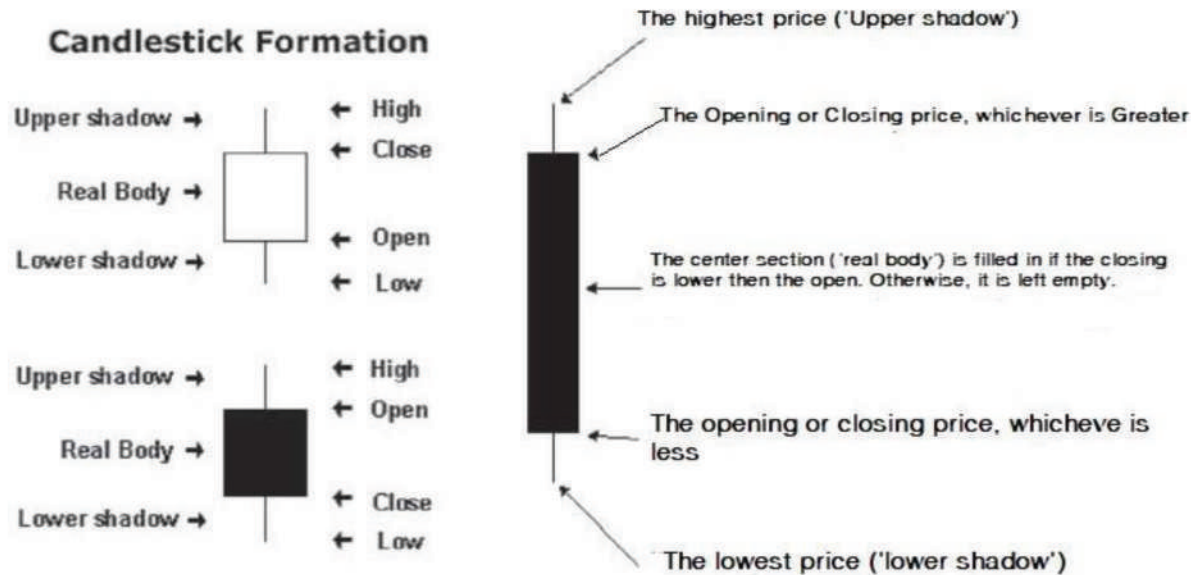


With 1-Day interval, 1-month chart of USDINR will be shown like this:



Candlesticks Chart

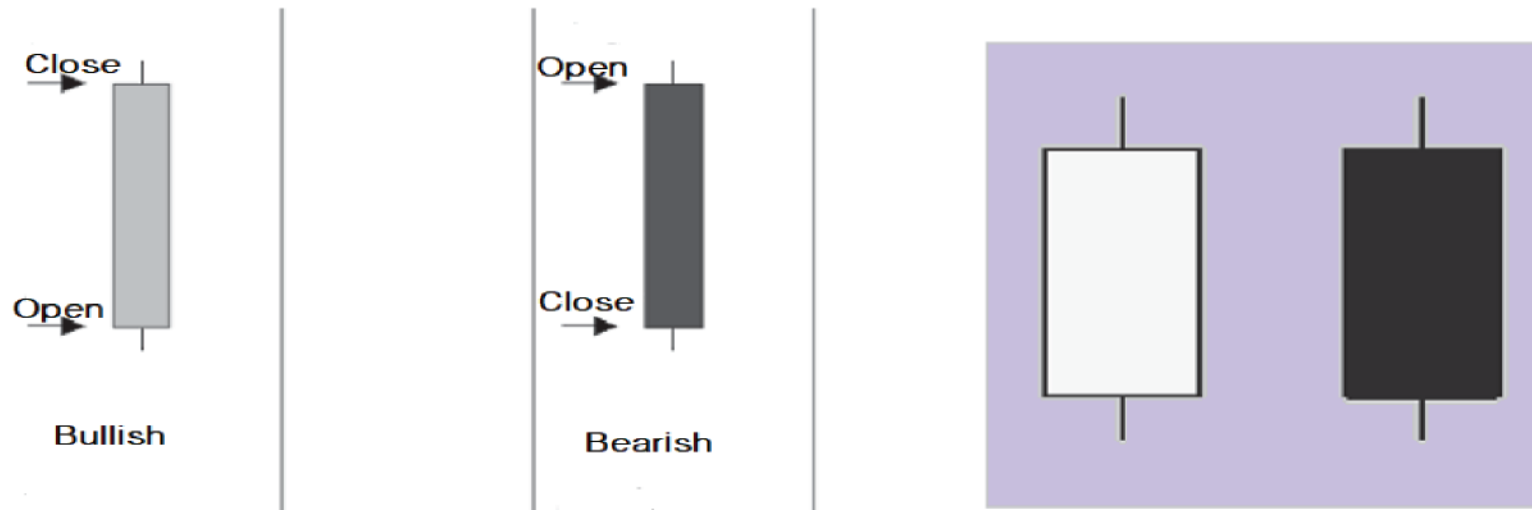
The candlesticks chart is very popular among the trader's community. This chart provides visual insight to current market psychology. A candlestick displays the open, high, low and closing price of a security very similar to a modern-day bar chart, but in a manner that mitigates the relationship between the opening and closing prices. Each candlestick represents one-time frame (e.g., day) of data. The figure given below displays various elements of a candle.



Elements of a Candle

A candlestick chart can be created using the data of High, Open, Low and Closing prices for each time period that you want to display. The middle portion (filled portion) of the candlestick is called "the body ("the real body"). The long thin lines above and below the body represent the high/low range and are called "shadows" (sometimes called "wicks" and "tails").

The body of the candlestick represents a stock's opening and closing price of the security (stock or currency pair).





The following image shows Candlestick chart of USDINR (3 month) on 1-Day interval. The color of the candlestick denotes a higher close in green whereas lower close in red, for the day.

The red candles in the above figure show days when the USDINR closed than the previous day. In contrast, green candles denotes days when the USDINR closed higher than the previous day.

Professional traders and investors sometimes prefer using candlestick chart because there are patterns in the candlesticks that can be actionable. However, candlestick charts consume time and skills to identify the patterns.

What is the chart pattern to use when trading?

The professional traders try to check the same security across different chart types. You may find one type of chart that works for you. Once we decided on what type of chart to follow, next step is to look for historical patterns like trends, support and resistance and other actionable patterns.

Forex Trading – Pattern study of Trends, Support and Resistance

In technical analysis, support and resistance represent the critical point where the forces of supply and demand meet. The other key points of TA, such as price patterns, are based on support and resistance points.

A support line refers to that level beyond which a stock (or currency pair) price will find buyers and chances of it (security) will not fall. Therefore, it denotes, the price level at which there is a sufficient amount of demand.

Similarly, a resistance line refers to that level beyond which a stock (or currency pair) price will find sellers and chances of it (security) will not rise. It indicates the price point at which there is sufficient amount of supply available to stop and possibly, for a time, turn upward trend.

Kinds of Trends

In the forex market, trends reflect the average rate of change in price over time. Trends exist in all markets (Equity, FX or commodity) and in all time frames (minutes to multi- years). A trend is one of the most important aspects, which traders need to understand. The traders should analyses which way the market or security (stock, currency pair) is heading and should take position based on that.

Following are the different types of trends in the forex market:

- Sideways trends (range bound)
- Uptrend (higher lows)
- Downtrend (lower highs)

Sideways Trends

Sideways trends indicate that a currency movement is range-bound between levels of support and resistance. It usually occurs when the market does not have a sense of direction and ends up consolidating most of the time in this range only.

To identify if it is a sideways trend, traders often draw horizontal lines connected by the highs and lows of the price, which then form resistance and support levels. Clearly, market participants are not sure of which way the market will move and there will be LITTLE or NO rate of price change.



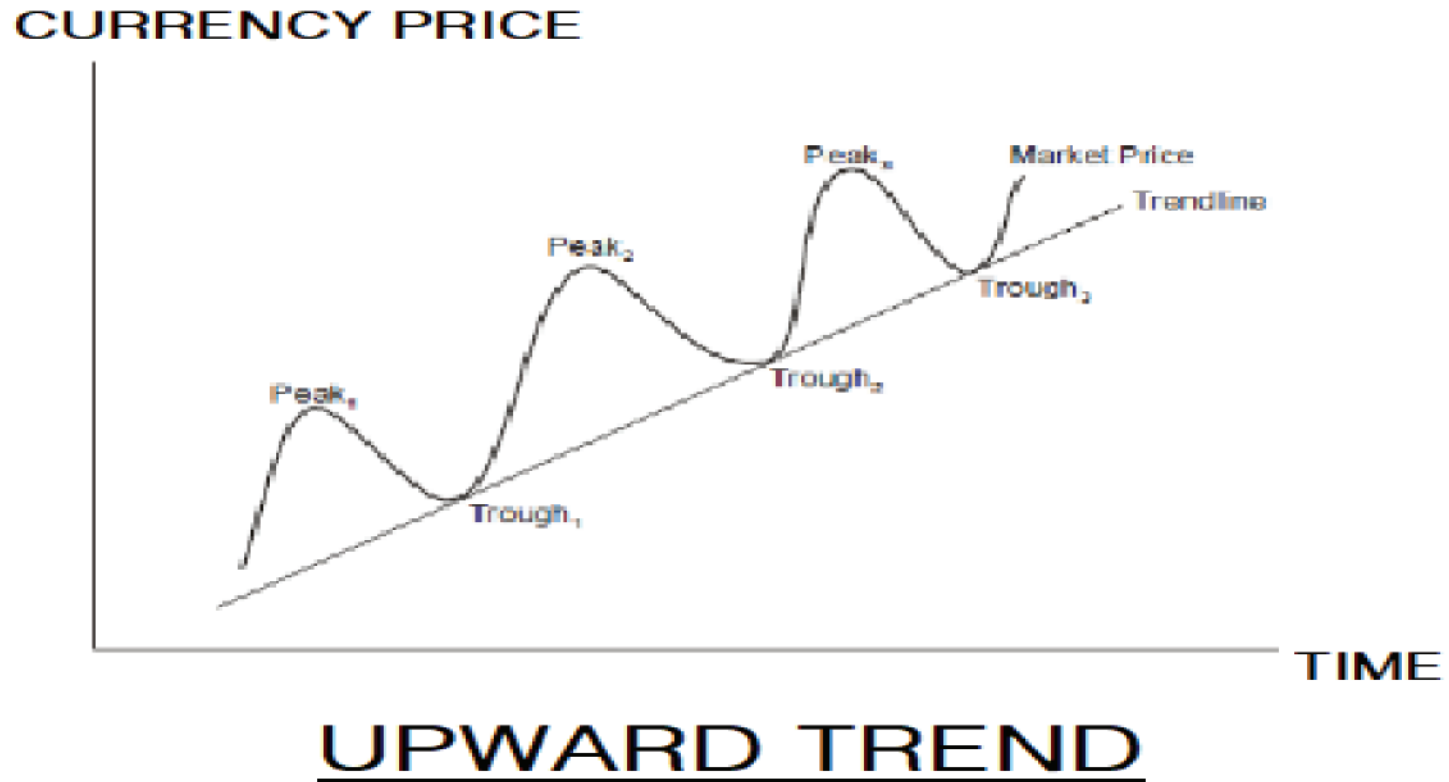
Uptrend

An uptrend signifies that the market is heading in the upward direction, creating a bullish market. It indicates the price rallies often with intermediate periods of consolidation or movement (small downward move) against the major (prevailing) trend.

An upward trend continues until there is some breakdown in the charts (going down below some major support areas). If the market trend is upwards, we need to be cautious on taking short position (against the overall market trend) on some minor correction in the market.



Another way to figure an upward trend of market or currency price is shown below:



Above the primary waves move the currency pair (USD/INR) in the direction of the broader trend (upward move), and secondary waves act as corrective phases (minor correction in currency, downward) of the primary waves (upward).

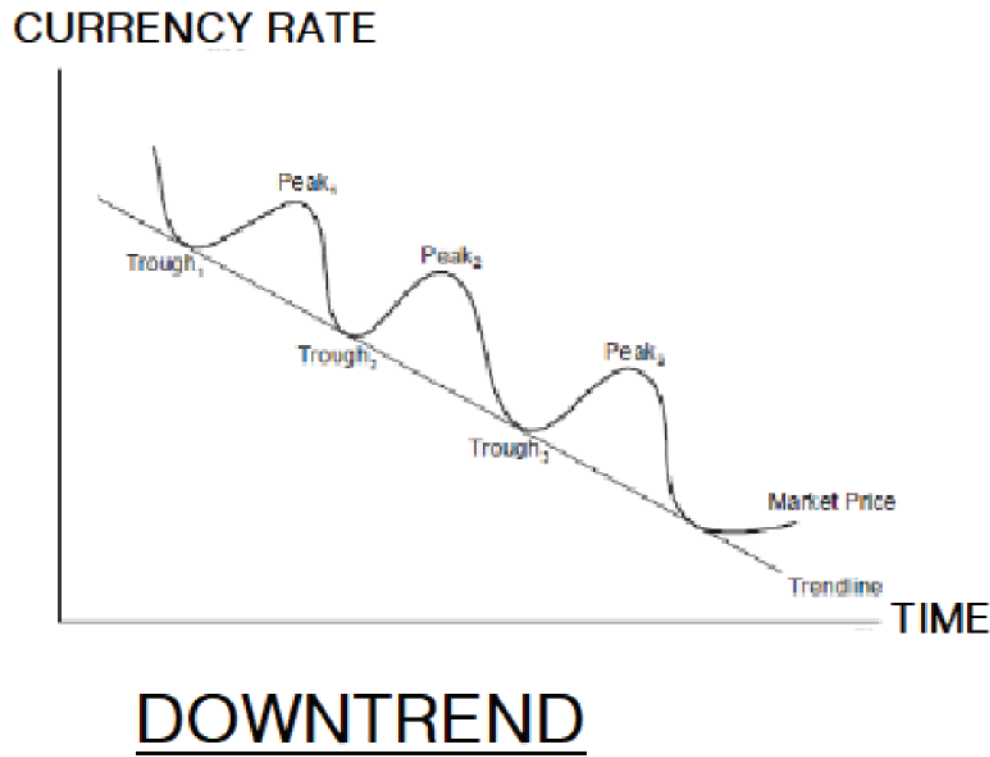
Downward Trend

A downward trend in the forex market is characterized by a price decline in the currency pair (USD/INR), with slight upward swing for a period of consolidation against the prevailing trend (downward trend). Unlike upward trend, a downward trend results in a negative rate of price change over time. In a chart, the price movements indicating a downtrend form a sequence of lower peaks and lower lows.

As currency is always traded in pair, the downtrend in forex market is not much affected as other financial markets. In case of downtrend of a currency pair (USD/INR), the fall in price of USD gives way to a rise in price of INR. It means something is always going up even in times of financial or economical downtrend.



Another way to look at the downward trend figure is in the form of primary (major trend) and secondary (minor correction) wave, as shown in the diagram below.



In the above figure, the primary wave (downtrend) moves the currency pair in the direction of the broader trend (downward trend), and secondary waves (uptrend) act as corrective phases of the primary waves (downtrend).

The Trendline

The basic principle of technical analysis is that we can identify future trends and to some extent the duration of that trend (upward or downward). During a bull market, we see a series of higher (upward or primary wave) highs and correction lows (downward or secondary wave) and in a bear market, lower downswings (primary wave) and correction highs (secondary wave).

Drawing trendlines correctly is the legitimate extension of identifying the support and resistance levels and providing opportunities to open and close positions.



EUR/USD, DOWNWARD AND UPWARD TRENDLINES

Trendlines are drawn at an angle above or below the price.

The above chart shows the trendline with downward and upward trends for a EUR/USD currency pair. In addition, we can see the following in the chart:

- Three swing highs on the downtrend
- Three swing lows on the uptrend.

Therefore, when drawing trendlines in a downtrend, we draw them above the price and when drawing trend lines in an uptrend, we draw them below the price.

During a downtrend, it is the high point and in uptrend, it is the low point that will determine a trend line.

For confirmation, we require at least three swing highs or three swing lows to draw a trend line in either direction (uptrend or downtrend). Higher the number of times the price touches a trend line, the more acceptable it is, as more traders are using it for the support and resistance levels.

Using trend lines to trade

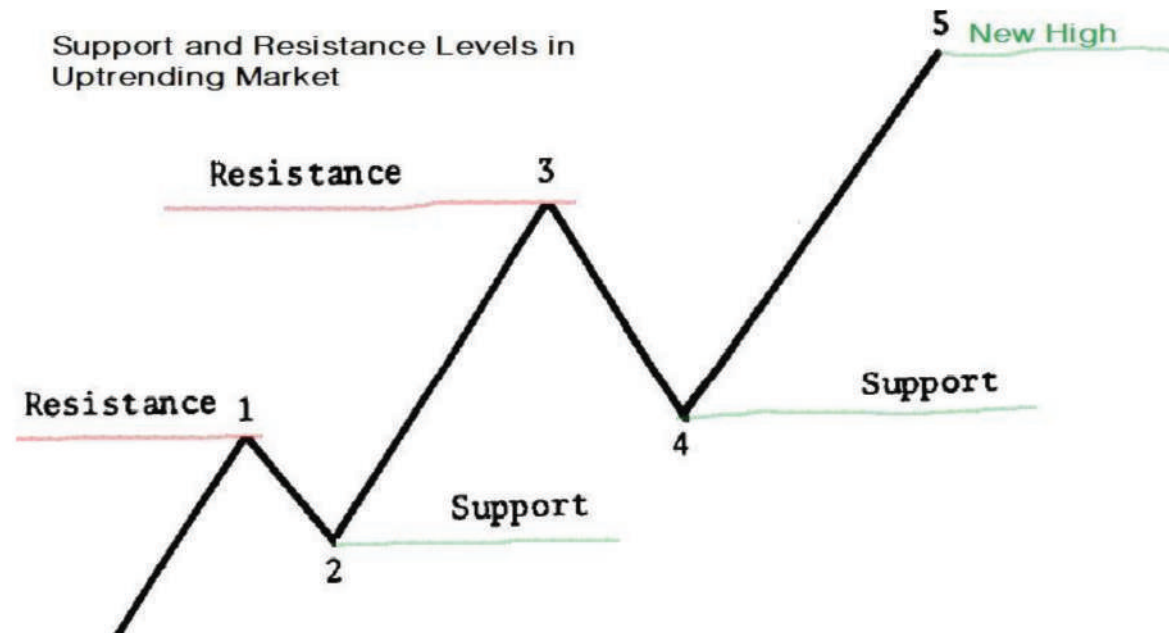
Most traders frequently use two methods to trade using trend lines:

- Entry or exit when the price finds support or resistance at the trend line.
- Entering when the price breaks through the trend line.

Trend line as support or resistance

As support is equal to demand and resistance signifies supply, it is the imbalance between supply and demand, which triggers price movement. If both supply and demand are static, there will be no price movement. Security prices stop falling and reverses when support/demand is below the current price. Similarly, security uptrend will stop its upward journey when resistance/supply is above the current price.

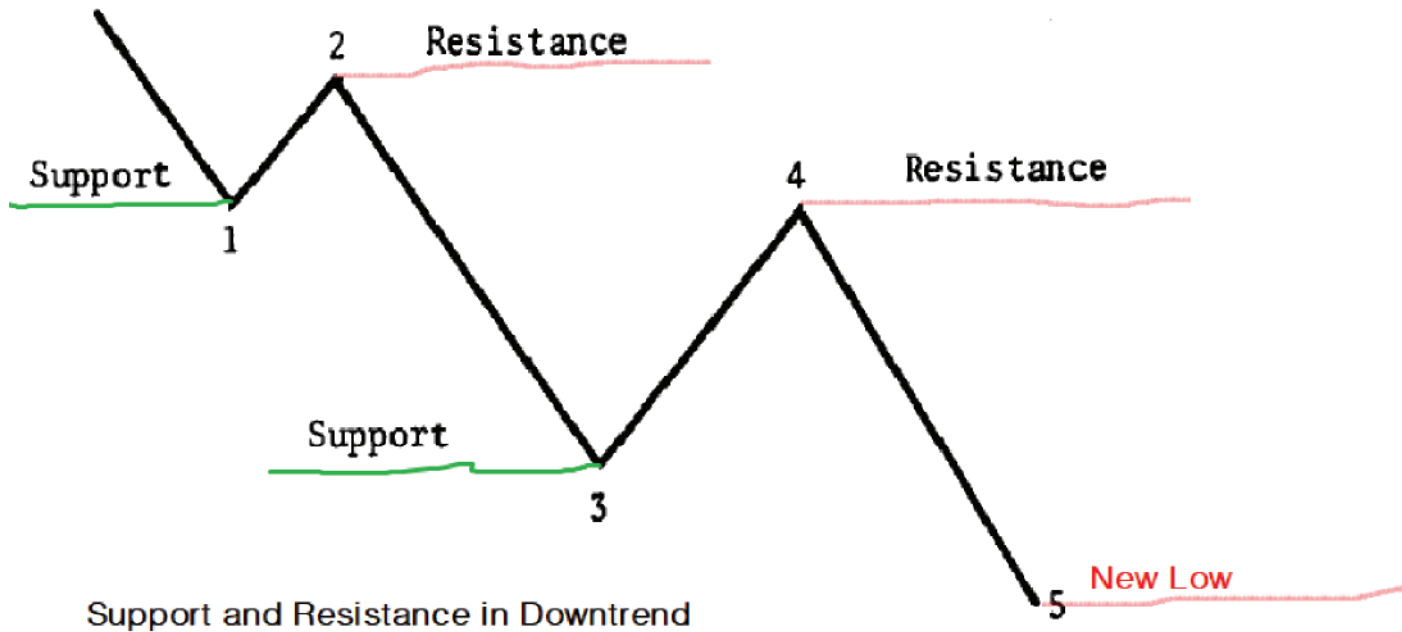
So in up trending market, each new resistance (higher levels) will be set. If the security(equity or currency pair) or market is in uncharted territory,



there is no resistance level set (can reach any new high).

Support and Resistance Levels in Uptrend

Similarly in a downtrend, the security (equity or currency pair)/ market is making new lows thereby going below the multi support levels. If the security/market is in downtrend and going down below all-time lows, finding exact support levels is not possible (only way is to go with retracement levels.)



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