Forex Trading

Currency trading can have a couple of meanings. If you want to learn about how to save time and money on currency transfers, read the article discuss about - as buying and selling currency on the foreign exchange (or "Forex") market with the intent to make money.

How Forex Works

The currency exchange rate is the rate at which one currency can be exchanged for another. It is always quoted in pairs like the EUR/USD (the Euro and the US Dollar). Exchange rates fluctuate based on economic factors like inflation, industrial production and geopolitical events. These factors will influence whether you buy or sell a currency pair.

Example of a Forex Trade:
The EUR/USD rate represents the number of US Dollars one Euro can purchase. If you believe that the Euro will increase in value against the US Dollar, you will buy Euros with US Dollars. If the exchange rate rises, you will sell the Euros back, making a profit. Please keep in mind that forex trading involves a high risk of loss.

Why Trade Currencies?

Forex is the world's largest market, with about 3.2 trillion US dollars in daily volume and 24-hour market action. Some key differences between Forex and Equities markets are:

1. Many firms don't charge commissions – you pay only the bid/ask spreads.
2. There's 24 hour trading – you dictate when to trade and how to trade.
3. You can trade on leverage, but this can magnify potential gains and losses.
4. You can focus on picking from a few currencies rather than from 5000 stocks.
5. Forex is accessible – you don’t need a lot of money to get started.

Why Currency Trading Is Not For Everyone

Trading foreign exchange on margin carries a high level of risk, and may not be suitable for everyone. Before deciding to trade foreign exchange you should carefully consider your investment objectives, level of experience, and risk appetite. Remember, you could sustain a loss of some or all of your initial investment, which means that you should not invest money that you cannot afford to lose. If you have any doubts, it is advisable to seek advice from an independent financial advisor.

What you should know before you get on board.

Lately, currencies have been on a rollercoaster ride with record breaking highs and lows. The world of foreign exchange is dominating news headlines; but what does it mean, and more importantly, what do you need to know before you get on board?

First of all, it's important that you understand that trading the Foreign Exchange market involves a high degree of risk, including the risk of losing money. Any investment in foreign exchange should involve only risk capital and you should never trade with money that you cannot afford to lose.

What is Forex?

You may have noticed that the value of currencies goes up and down every day. What most people don't realize is that there is a foreign exchange market - or 'Forex' for short - where you can potentially profit from the movement of these currencies. The best known example is George Soros who made a billion dollars in a day by trading currencies. Be aware, however, that currency trading involves significant risk and individuals can lose a substantial part of their investment. As technologies have improved, the Forex market has become more accessible resulting in an unprecedented growth in online trading. One of the great things about trading currencies now is that you no longer have to be a big money manager to trade this market; traders and investors like you and I can trade this market.

Forex in a nutshell

The Forex market is the largest financial market on Earth. Its average daily trading volume is more than $3.2 trillion. Compare that with the New York Stock Exchange, which only has an average daily trading volume of $55 billion. In fact, if you were to put ALL of the world's equity and futures markets together, their combined trading volume would only equal a QUARTER of the Forex market. Why is size important? Because there are so many buyers and sellers that transaction prices are kept low. If you're wondering how trading the Forex market is different then trading stocks, here are a few major benefits.

1. Many firms don't charge commissions – you pay only the bid/ask spreads.
2. There's 24 hour trading – you dictate when to trade and how to trade.
3. You can trade on leverage, but this can magnify potential gains and losses.
4. You can focus on picking from a few currencies rather than from 5000 stocks.
5. Forex is accessible – you don't need a lot of money to get started.

How is Forex traded?

The mechanics of a trade are virtually identical to those in other markets. The only difference is that you're buying one currency and selling another at the same time. That's why currencies are quoted in pairs, like EUR/USD or USD/JPY. The exchange rate represents the purchase price between the two currencies.

Example:
The EUR/USD rate represents the number of USD one EUR can buy. If you think the Euro will increase in value against the US Dollar, you buy Euros with US Dollars. If the exchange rate rises, you sell the Euros back, and you cash in your profit. Please keep in mind that forex trading involves a high risk of loss.

Important: be aware of the risks:

Finally, it cannot be stressed enough that trading foreign exchange on margin carries a high level of risk, and may not be suitable for everyone. Before deciding to trade foreign exchange you should carefully consider your investment objectives, level of experience, and risk appetite. Remember, you could sustain a loss of some or all of your initial investment, which means that you should not invest money that you cannot afford to lose. If you have any doubts, we recommend that you seek advice from an independent financial advisor.

Tools and techniques used by professional traders

Know the Language

In Currency Trading, traders often use technical language that can be intimidating when you're just starting out. When you see a word you don't understand, you should refer to the Commonly used terms. As you familiarize yourself with the language, you'll find that your understanding of Forex concepts as a whole will improve.

Technical Analysis

To develop a strategy, traders use a variety of tools and techniques. Some traders perform Technical Analysis by using currency charts to study the market. This technique assumes that past market movements will help predict future activity. The effectiveness of Technical Analysis makes it a very popular trading technique.

Fundamental Analysis

Other traders use Fundamental Analysis for their trading strategy. They follow the effect of economic, social and political events on currency prices. Reading specialized forex news can help keep you in touch with the Forex community to find out how events might affect currency prices.

Practice makes perfect!

Every trader makes mistakes, so it's a good idea to familiarize yourself with a trading environment before you invest your money. To improve your trading skills, try opening a free demo trading account with a Forex company.

Know the Risks

Trading foreign exchange on margin carries a high level of risk, and may not be suitable for everyone. Before deciding to trade foreign exchange you should carefully consider your investment objectives, level of experience, and risk appetite. Remember, you could sustain a loss of some or all of your initial investment, which means that you should not invest money that you cannot afford to lose. If you have any doubts, it is advisable to seek advice from an independent financial advisor.

Six steps to improve your currency trading

Whether you're new to Currency Trading or a seasoned trader, you can always improve your trading skills. Education is fundamental to successful trading. Here are six steps that will help hone your Currency trading skills.

STEPS

- 1. Strategize, Analyze and Diarize
- 2. Learn to Manage Your Risk
- 3. Choose Your Approach
- 4. Chart Your Course with Technical Analysis
- 5. Be In The Know with Fundamental Analysis

- 6. Beware of Psychological Pitfalls

STEP 1: NEXT STEP ► Strategize, Analyze and Diarize

Successful professional traders do three things that amateurs often forget. They plan a trading strategy, they follow the markets, and they diarize, track, and analyze each of their trades.

1. **Plan How You Will Trade**
   You may have heard the adage, "if you fail to plan, you plan to fail." This is particularly true in Forex speculation.

   Successful traders start with a sound strategy and they stick to it at all times.

   - **Choose the currency pairs that are right for you.**
     Some currency pairs are volatile and move a lot intra-day. Some currency pairs are steady and make slow moves over longer time periods. Based on your risk parameters, decide which currency pairs are best suited to your trading strategy.
   - **Decide how long you plan to stay in a position.**
     Based on your currency pair selection, plan how long you want to hold your positions: minutes, hours, or days. Remember that depending on your account type, having open positions at 5:00pm Eastern Time may incur rollover charges.
   - **Set your targets for the position.**
     Before you take a position you should establish your exit strategy. If the position is a winner, at what rate will you cash out? If the position is a loser, at what rate will you cut your losses? Then, place your stops and limits accordingly.

2. **Follow the Forex Market**
   Use Forex charts and Forex news to monitor market information and technical levels that affect your positions.

   - **Use Forex Charts**
     Charts are an indispensable tool to improve trading returns. You can easily recoup the money spent on a charting package from a single well-placed trade based on the analysis from professional charts. Please keep in mind that forex trading involves a high risk of loss, and no guarantee is made that the investment on the charting applications will be recouped.
   - **Follow Forex News**
     forex news provides breaking Forex news on economic reports and political events that influence the currency market. You can access detailed market commentary and trading strategies from experienced Forex traders.

3. **Keep a Forex Diary**
   Most traders fail because they make the same mistakes over and over. A diary can help by keeping track of what works for you and what doesn't. Used consistently, a well-kept diary is your best friend. When keeping your diary, make sure that it contains at least the following:
   1. The date and time you took the position.
   2. The rate at which you took the position.
   3. The reason you took the position.
   4. Your strategy for the position.
   5. The date and time you exited the position.
   6. The rate at which you exited the position.

7. Your profit/loss on the position.

8. Why you exited the position. Did you follow you strategy?

Once you learn to recognize successful trading patterns, you will be able to spot them when they return.

STEP 2: NEXT STEP ► Learn to Manage Your Risk

In our experience, the most successful traders are not simply the ones who take the best positions. They are the ones that are smartest about risk management and disciplined in their strategy. They are never emotional about gains or losses. They set their profit target and loss limits for their positions, and use Limit Orders and Stop/Loss Orders to lock them in.

Limit Orders

A limit order instructs the system to automatically exit a position when your target profit has been achieved. This enables you to "lock in" your desired profit on a winning position.

Stop/Loss Orders

A stop/loss order instructs the system to automatically exit a position when your maximum loss limit has been hit. This enables you to cap your losses on a losing position.

Trading Discipline

Professional Traders use Limit Orders and Stop/Loss Orders as the cornerstone of a disciplined trading strategy. By setting both on all their positions, they have removed emotion from the equation and are letting the market work for them.

Amateurs, on the other hand, dont use Limit Orders and Stop/Loss Orders. They stay glued to their screens, trying to juggle all their positions in real time. They miss critical action points, and they let emotion rule their decisions.

Setting Limit and Stop/Loss Orders

As a general rule of thumb, you your Stop/Loss Orders should be set closer to the opening position price than your Limit Orders. If you do this, then you can be successful while being right less than 50% of the time.

For example, if you use a 100 pip Limit Order with a 30 pip Stop/Loss Order on all your positions, then you only to be right 1/3 of the time to make a profit.

Where you place your Limit and Stop/Loss Orders will depend on your risk tolerance. However, you need to be smart when setting them. If a Stop/Loss Order is too close to the opening position price, it can be triggered by normal market volatility. This means that a temporary dip can knock out a position before it has a chance to retrace. Similarly, if a Limit Order is set too far from the opening price, potential profit may never be realized.

STEP 3: NEXT STEP ► Choose Your Approach

There are two basic approaches to analyzing the Forex market. It is important to understand how they can be used successfully.

Technical Analysis

Technical Analysis focuses on the study of price movements, using historical currency data to try to predict the direction of future prices. The premise is that all available market information is already reflected in the price of any currency, and that all you need to do is study price movements to make informed trading decisions.

The primary tools of Technical Analysis are charts. Charts are used to identify trends and patterns in an attempt to find profit opportunities. Those who follow this approach look for trending tendencies in the Forex markets, and say that the key to success is identifying such trends in their earliest stage of development.

Fundamental Analysis

Fundamental Analysis focuses on the economic, social, and political forces that drive supply and demand. The premise is that macroeconomic indicators such as economic growth rates, interest rates, inflation, and unemployment can be used to make informed trading decisions. Information about economic data can be found using which is free to use.

There is no single set of beliefs that guide Fundamental Analysis. Different traders look to different indicators, and weigh various indicators in different ways.

What should I use - Technical or Fundamental Analysis?

Traders using Technical Analysis follow charts and trends, typically following a number currency pairs simultaneously. Traders using Fundamental Analysis must sort through a great deal of market data, and so typically focus on only a few currency pairs. For this reason, many traders prefer Technical Analysis.

In addition, many traders choose Technical Analysis because they see strong trending tendencies in the Forex market. They look to master the fundamentals of Technical Analysis and apply them to numerous time frames and currency pairs.

STEP 4: NEXT STEP ► Chart Your Course with Technical Analysis

Technical Analysis uses charts to try to forecast future currency prices by studying past market movements. Using this technique, a trader has the ability to simultaneously monitor multiple currency pairs by evaluating how others are trading a particular currency. In our experience, because so many traders use technical analysis, and their reaction to market activity tends to be similar, the validity of this technique is strengthened. It becomes a self-fulfilling prophecy that feeds on itself, increasing the reliability of the signals generated from this analysis.

Support & Resistance

Perhaps the most effective and therefore the most popular form of technical analyses is the use of "support" and "resistance". Support is the "floor" or lower boundary that a currency pair has trouble breaching. Resistance, on the other hand, is simply the opposite: it is the upper boundary that a currency pair has trouble penetrating.

Support and Resistance are important in range bound markets because they indicate the boundaries where the market tends to change direction. When and if the market breaks through these boundaries, it is referred to as a "breakout" and is usually followed by increased market activity.

Using Support & Resistance

We can use these support and resistance levels in many ways. A range trader would want to buy above support and sell below resistance while breakout. Trend traders, on the other hand, would buy when the price breaks above a level of resistance and sell when it breaks below support.

The concept is still the same as we stated earlier. We want to buy a currency pair if we anticipate the market moving up and then sell it at higher price. We can also sell a currency pair if we anticipate the market moving down and then buy it at a lower price.

STEP 5: NEXT STEP ► Be In The Know with Fundamental Analysis

What influences prices in the currencies market?

Traders use fundamental analysis to try to forecast the effect that economic, social, and political events will have on currency prices. Prices in the currency market are affected by macroeconomic factors such as inflation, unemployment and industrial production. Based on the analysis of economic data, traders will take positions on the market with the objective of making a profit.

Finding information about economic data is relatively easy. for example, provides streaming news and market commentary and is available for free.

Traders should focus on three main macroeconomic factors when analyzing foreign exchange rates:

Interest Rates

Each currency has an overnight lending rate determined by that country's central bank. If inflation is deemed too high, a central bank may raise the interest rate to cool down the economy. Conversely, if economic activity is sluggish, a central bank may reduce interest rates to stimulate growth. Lower interest rates usually depreciate the value of a currency – in part, because it attracts carry-trades. A carry-trade is a strategy in which a trader sells a currency with a low interest rate and buys a currency with a high interest.

Employment

The unemployment rate is a key indicator of economic strength. If a country has a high unemployment rate, it means that the economy is not strong enough to provide people with jobs. This leads to a decline in the currency value.

Geopolitical Events

These key international political events affect the foreign exchange market, as well as all other markets.

Example

In May of 2005, there was growing anticipation that France would vote against accepting the European Union Constitution. Since France was vital to Europe's economic health (and the value of the Euro), traders sold the Euro and bought the dollar; this pushed the Euro down so far that many traders thought it couldn't go any lower.

But, they were wrong. When France actually voted against the constitution, the EUR/USD currency pair fell by more than 400 pips in three days. Traders who bought the Euro lost thousands. On the other hand, traders selling the Euro made thousands.

STEP 6: Beware of Psychological Pitfalls

Many traders take shopping more seriously than trading. Few people would spend $500 without carefully researching and examining a product. But many traders take positions that cost them well over $500 based on little more than a hunch.

This cannot be stressed enough. Most traders fail because they lack discipline. Be sure that you have a plan in place before you start to trade. Your analysis should include the potential downside as well as the expected upside. So for every position you take, you should place both a Limit Order and a Stop/Loss Order.

Set Smart Trade Limits

For each trade, choose a profit target that will let you make good money on the position without being unachievable. Choose a loss limit that is large enough to accommodate normal market fluctuations, but smaller than your profit target. Lock these in using Limit Orders and Stop/Loss Orders.

This simple concept is one of the most difficult to follow. Many traders abandon their predetermined plans on a whim, closing winning positions before their profit targets are reached because they grow nervous that the market will turn against them. But those same traders will hang on to losing positions well past their loss limits, hoping to somehow recover their losses.

Sometimes traders see their loss limits hit a few times, only to see the market go back in their favor once they are out. This can lead to mistaken belief that this will always keep happening, and that loss limits are counterproductive. Nothing could be further from the truth! Stop/Loss Orders are there to limit your losses.

No trader makes money on every trade. If you can get 5 trades out of 10 to be profitable, then you are doing well. How then do you make money with only half of your positions being winners? By setting smart trade limits. When you lose less on your losers than you make on your winners, you are profitable.

Don't Marry Your Trades

People are emotional. It is easy to do objective analysis before taking a position. It is much harder when you've got money invested. Traders holding positions tend to analyze the market differently in the hope that it will move in a favorable direction, ignoring changing factors that may have turned against their original analysis. This is especially true when losses are being taken on a position. Traders tend to 'marry' a losing position, disregarding signs that point towards continued losses.

Don't Bet the Farm

Do not over trade. A common mistake made by new traders is over-leveraging an account. Just because one lot (100,000 units) of currency only requires $1000 as a minimum margin deposit, it does not mean that a trader with $5000 in his account should be able to trade 5 lots. One lot is $100,000 and should be treated as a $100,000 investment and not the $1000 put up as margin. Most traders analyze the charts correctly and place sensible trades, yet they tend to over leverage themselves. As a consequence of this, they are often forced to exit a position at the wrong time. A good rule of thumb is to trade with 1-10 leverage or never use more than 10% of your account at any given time. Trading currencies is not easy (if it were, everyone would be a millionaire!).

Be aware that trading foreign exchange on margin carries a high level of risk, and may not be suitable for all investors. The high degree of leverage can work against you as well as for you. Before deciding to invest in foreign exchange you should carefully consider your investment objectives, level of experience, and risk appetite. The possibility exists that you could sustain a loss of some or all of your initial investment and therefore you should not invest money that you cannot afford to lose. You should be aware of all the risks associated with foreign exchange trading, and seek advice from an independent financial advisor if you have any doubts.

Does your Forex Broker cut the mustard?

The 15 Questions you should ask your Broker.

There are many Forex Brokers, but not all were created equal. When it comes to *your money*, you want to be certain that your Broker meets your expectations. It is *your right* to ask as many questions as you need to feel comfortable about your venture and if you don't get the answers your want, you should consider finding another Broker.

Why *Size* Does Matter

Size matters. Because the Forex market is an over-the-counter market with no centralized exchange, not everyone receives access to the same prices or quality of execution. Institutions with the largest trade volume and the most solid financials have access to better prices and execution. The bigger the broker, the better they are able to pass on the benefits of size, better prices, and better execution to you.

Who Ecutes Your Orders?

Not all Forex Brokers quote rates the same way. Below are two possible options:

1. **Dealing Desk** means that your Forex Broker creates the pricing and executes your orders. The spread is usually fixed, which means that traditionally, the spreads are higher than average variable spreads. Check for restrictions on placing orders during news or economic events; for many traders, this is a key time to trade.
2. **No Dealing Desk** usually means that multiple banks stream competing prices through your Forex Broker, so your orders are executed by the banks themselves. This means that there are usually no restrictions on trading news or economic events, but you should check with your broker.

Spreads

Fractional Pip Pricing

Most major currency pairs are quoted to four decimal places, so a pip would typically equal .0001 or one basis point. Forex Brokers generally round the price up or down to the nearest pip; but some now offer Fractional Pip-Pricing. It ads an additional decimal place, so spreads are usually tighter and more accurate.

Scalping the Market

Many traders favor short-term scalping strategies, which involves placing orders inside the spread. For scalping to be profitable for the client, the market maker must lose, so some Forex Brokers disallow the strategy. This strategy involves a high level of risk.

Rollover

Rollover is interest earned or paid on Forex positions held overnight. It varies depending on the difference in interest rates between a currency pair and fluctuates day to day with the movement of prices. A Negative Roll is when you sell a currency that pays higher interest rate, so you pay interest. A Positive Roll is when you buy a currency that pays higher interest rate, so you can earn interest. Negative Rolls are routine, but not all Forex Brokers offer positive rolls.

The "Carry Trade" is a popular Forex strategy which benefits from Positive Rolls and the high leverage available in the Forex market. For example, if you buy the USD/JPY, you can earn a positive roll. You are essentially borrowing the Japanese yen at a low interest rate cost to buy the US dollar with a high interest rate earning. Remember that leverage can dramatically amplify your losses, so beware of this technique, as it carries a high level of risk.

Hedging

Hedging lets you simultaneously hold BUY and SELL positions in the same currency pair. The most effective way to trade a market if you are uncertain about its direction is to find concrete support and resistance levels. This allows you to pinpoint levels where significant price action will take place.

Hedged positions do not necessarily limit risk as traders can find themselves losing on both sides of the trade. While this strategy tends to work temporarily in range markets, it does not work well in trending markets. Placing stop-loss orders on your positions to mitigate your risk is strongly recommended.

The National Futures Association, a self-regulatory organization in the US, adopted a new Compliance Rule 2-43 in 2009 that prohibits customers of Forex Dealer Members to open a "hedged" position in the same account. This rule may not apply to Forex Dealers outside of the US.

Customer Support

Forex trading works 24 hours a day. Does your Forex Broker? When you ask them questions, do they answer them clearly and honestly or do they give you the run-around? If your Forex Broker can’t answer the 15 questions below, you may want to look for one who can.

15 Questions You Should Ask Your Forex Broker

The following 15 questions are based on the above information and relate to basic information that your Forex Broker should answer without hesitation.

1. How long have you been a Forex Broker?
2. In what financial condition is your company? Will you show me your balance sheet?
3. Do you have good relationships with reputable banks?
4. Who is quoting the rates, my broker, a bank, or multiple banks?
5. Are the spreads fixed of variable?
6. How tight are the spreads?
7. Do you offer Fractional Pip Pricing?
8. Are there any trading restrictions?
9. Can I place orders inside the Spread?

10. Can I earn interest on positive rolls?
11. Can I earn positive rolls at all margin levels?
12. Are rollover rates displayed prominently? Where?
13. Does the trading platform allow me to hedge?
14. Can I lose more money than I put into my account?
15. What is the quality and availability of customer service?

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Are You Ready To Trade Currency?

We recommend the following steps.

If you are interested in trading currencies, we recommend that you take the following steps.

1. Learn the Basics

Why do currency rates fluctuate? How does a forex trade work? Learn the nuts and bolts of trading currencies. By reading this series of featured articles, you're already on the right track. It's also important that you understand that trading the Foreign Exchange market involves a high degree of risk, including the risk of losing money. Any investment in foreign exchange should involve only risk capital and you should never trade with money that you cannot afford to lose. Once you know your basics, you're ready to take the next step.

2. Test your skills with a Demo

One of the best ways to see if currency trading is right for you is to try a trading demo. You can practice your trading techniques with "play money", so there is no risk involved. What are the perks? Most Forex Dealers offer demos for free, so you get a lot of free information, and sometimes even free customer support to help you ease into currency trading.

3. Open a Live Account

If you're ready to trade, there are a lot of Forex companies to choose from. Make sure you are comfortable with your chosen broker and don’t be afraid to ask questions. Consider your investment objectives, level of experience, and risk appetite, as the possibility exists that you could lose some or all of your initial investment. Do not invest money that you cannot afford to lose and be aware of the risks associated with foreign exchange trading. If you have any doubts, seek advice from an independent financial advisor. Good luck!

Know the Language

In Currency Trading, traders often use technical language that can be intimidating when you're just starting out. When you see a word you don't understand, you should refer to this page. As you familiarize yourself with the language, you'll find that your understanding of Forex concepts as a whole will improve.

A

Account
A record of transactions of goods and services owed to one person by another.

Agent
An intermediary or person hired to carry out transactions on behalf of another person.

Aggregate Demand
Total demand in an economy, consisting of government spending, private/consumer and business investment.

All or None
Refers to requests for a broker to fill an order completely at a predetermined price or not at all. Refers to both buy and sell orders.

American Option
An option that can be exercised anytime during its life. The majority of exchange-traded options are American.

Anonymous Trading
Visible bids and offers on the market without the identity of the bidder and seller being revealed. Anonymous trades allow the high profile investors to execute transactions without the scrutiny and speculation of the market.

Appreciation
An increase in the value of a currency in response to market demand.

Arbitrage
When a price differential arises, creating an opportunity to profit through buying and selling. Arbitrage is a "riskless" opportunity to profit, as there is no uncertainty involved. In regards to the foreign exchange market, arbitrage arises when a profit can be made through differentials in exchange rates. Arbitrage opportunities in the foreign exchange market are rare.

Asian Option
An option whose payoff depends on the average price of the underlying asset over a certain period of time. These types of option contracts are attractive because they tend to cost less than regular American options

Ask Rate
The lowest price that shares will be offered for sale, such as the bid/ask spread in the foreign exchange market.

Ask Size
The number of shares a seller is willing to sell at his/her ask rate.

Asset Allocation
The diversification of one's assets into different sectors, such as real estate, stocks, bonds, and forex, to optimize growth potential and minimize risk.

Asset Swap
An interest rate swap used to alter the cash flow characteristics of an institution's assets in order to provide a better match with its liabilities.

Attorney in Fact
A person given the right or authority to act on behalf of another to carryout business transactions and implement documents.

Authorized Dealer
A financial institution or bank authorized to deal in foreign exchange.

Automatic Exercise
A procedure implemented to protect an option holder where the Option Clearing Corporation will automatically exercise an "in the money" option for the holder.

Away From the Market
When the bid on an order is lower (or the ask price is higher) than the current market price for the security.

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B

Back Office
Refers to the administrative arm of financial service companies, who carry out and confirm financial transactions. Duties include accounting, settlements, clearances, regulatory compliance and record maintenance.

Balance/Account Balance
The net value of an account.

Balance of Payments
A record of all transactions made by one particular country with others during a certain time period. It compares the amount of economic transactions between a country and all other countries. This includes trade balance, foreign investments, and investments by foreigners.

Balance of Trade
Net flow of goods (exports minus its imports) between two countries.

Bank for International Settlements
The BIS is an international organization fostering the cooperation of central banks and international financial institutions. Essentially, the BIS, located in Basel, is a central bank for central banks. It monitors and collects data on international banking activity and promulgates rules concerning international bank regulation.

Base Currency
In general terms, the base currency is the currency in which an investor or issuer maintains its book of accounts. In the FX markets, the US Dollar is normally considered the 'base' currency for quotes, meaning that quotes are expressed as a unit of $1 USD per the other currency quoted in the pair. The primary exceptions to this rule are the British Pound, the Euro and the Australian Dollar.

Basis
The difference between the cash price and the futures price.

Basis Point
Measure of a bond's yield equal to 1/100th. A 1% change in yield is equal to 100 basis points and 0.01% is equal to one basis point.

Bear
Investor acting on the belief that prices or the market will decline.

Bear Market
Any market that exhibits a declining trend. In the long run they have a down turn of 20% or more.

Bid
The price an investor is willing to pay for an asset.

Bid/Ask Spread
The difference between the bid and the ask price.

Big Figure
Refers to the first number to the left of the decimal point in an exchange rate quote, which changes so infrequently that dealers often omit them in quotes.

Bonds
Bonds are debt instruments used to raise capital, which are issued for periods greater than one year. Bondholders are loaning money (investing in debt) to companies and governments, at the end of which they will be paid a specified interest rate. Bond prices are inversely related to interest rates, as interest rates rise, bond prices fall. There are numerous types of bonds, including treasury bonds, notes, and bills; municipal bonds and corporate bonds.

Book
Recording of the total positions held by a trader or desk.

Bretton Woods Accord (1944)
This accord established a fixed exchange rate regime, whose aim was to provide stability in the world economy after the Great Depression and the WWII. This accord fixed the exchange rates of major currencies to the US dollar and set the price of gold to $35. The accord required central bank intervention to maintain the fixed exchange rates. The US Central Bank was required to exchange dollars for gold, which eventually let to the demise of this system, when the demand for the dollar declined, as well as the gold reserves, forcing Nixon to stop the exchange of dollars for gold, effectively ending the system in 1971.

Broker
Individual or firm acting as an intermediary to bring together buyers and sellers typically for a commission or fee.

Bull
Investor who expects markets or prices to rise.

Bull Market
A market where prices are rising or are expected to rise.

Bundesbank
Germany's Central Bank.

Buy a bounce
A recommendation to instigate a long trade if the price bounces from a certain level.

Buy break
A recommendation to buy the currency pair if it breaks the current level specified.

Buy stops above
A recommendation to enter the market when the exchange rate breaks through a specific level. The client placing a stop entry order believes that when the market's momentum breaks through a specified level, the rate will continue in that direction.

C

Cable
Term used to describe the exchange rate between the US dollar and the British Pound.

Candlestick Chart
Chart depicting the daily high, low, opening and closing price, similar to that of a bar chart. If the close is lower than the open than the body of the candlestick is filled in, and if the open is lower than the close the body is left empty.

Capital Markets
Markets in which capital (stocks, bonds, etc.) are traded. Usually for medium or long term investing.

Carry Trade
An investment position of buying a higher yielding currency with the capital of a lower yielding currency to gain an interest rate differential.

Central Bank
A banking organization, usually independent of government, responsible for implementing a country's monetary policy and for printing money.

Chartist
Refers to a technical analyst or one who analyses charts/graphs and data to uncover potential trends.

Clearing
Refers to the settlements/confirmations of trades.

Close a Position (Position Squaring)
Refers to getting rid of a position, either by buying back a short position or selling a long position.

Commission
A fee charged by broker or agent for carrying out transactions/orders.

Confirmation
A written document verifying the completion of a trade/transaction to include such things as date, fees or commissions, settlement terms and the price.

Contagion
Term used to describe the spread of economic crises from one country's market to other countries within close geographic proximity. This term was first used following the Asian Financial Crisis in 1997, which began in and soon spread to other East Asian economies. It now is used to refer to the recent crisis in and its effects on other Latin American countries.

Contract (Unit or Lot)
The standard trading unit on certain exchanges. A standard lot in the forex market is $100,000.

Convertible Currency
Currencies that can be exchanged for other currencies or gold.

Cost of Carry
When an investor borrows money to sustain a position. There is a cost for borrowing derived from the interest parity condition, which is used to determine the forward price.

Counterparty
A participant, either a person or an institution, involved in one side of a financial transaction. With such transaction there is an associated risk (counterparty risk) involved that the counterparty will not be able to meet the terms outlined in the contract. This risk is usually default risk.

Country Risk
The risk that a government might default on its financial commitments/contracts, which typically causes harms to other areas of the financial sector, as well as those in other countries.

Cover on a Bounce
A recommendation to exit trades on a bounce out of a support level.

Cover on Approach
A recommendation to exit trades for profit on approach to a support level.

Credit Checking
Before making a large financial transaction, it imperative to check whether the counterparty has enough available credit to carryout/honor the transaction. Credit checking refers to the process of verifying that counterparty has enough credit. The check is initiated after the price has been determined.

Credit Netting
Agreements that are made to avoid having to continually recheck credit, usually established between large banks and trading institutions.

Cross Rate
Refers to the exchange rate between two countries' currencies. Cross rates usually refer to pairs quoted that do not include the domestic currency. For example, in the US, the EUR/JPY rate would be called a cross rate.

Currency
Notes and coins issued by the central bank or government, serving as legal tender for trade.

Currency Pair
Currencies are quoted in pairs, such as EUR/USD or USD/JPY. The first listed currency is known as the base currency, while the second is called the counter or quote currency. The base currency is the "basis" for the buy or the sell. For example, if you BUY EUR/USD you have bought euros and simultaneously sold dollars. You would do so in expectation that the euro will appreciate (increase in value) relative to the US dollar.

Currency (Exchange Rate) Risk
Risk associated with drastic changes/fluctuations in exchange rates in which one could incur a major loss.

D

Day Trading
Refers to the process of entering and closing out trades within the same day or trading session.

Dealer
One who places the order to buy or sell. A dealer differs from an agent in that it takes ownership of the asset, and thereby is exposed to some risk.

Deficit
An excess of liabilities over assets, of losses over profits, or of expenditure over income.

Delivery
Term used to describe the exchange by both parties (buyer and seller) of the traded currency.

Deposit
Refers to the process of borrowing and lending money. The deposit rate is the rate at which money can be borrowed or lent.

Depreciation
The decline in the value of an asset or currency.

Derivative
A security derived from another and whose value is dependent the underlying security from which it is derived. Examples of derivatives are future contracts, forward contracts and options. Underlying securities can include stocks, bonds or currencies. Derivatives can be traded and are usually used to hedge portfolio risk.

Devaluation
When the value of a currency is lowered against the other, i.e. it takes more units of the domestic currency to purchase a foreign currency. This differs from depreciation in that depreciation occurs through changes in demand in the foreign exchange market, whereas devaluation typically arises from government policy. A currency is usually devalued to improve the balance of trade, as exports become cheaper for the rest of the world and imports more expensive to domestic consumers.

Dirty Float (Managed Float)
An exchange rate system in which the currency is not pegged, but is “managed” by the central bank to prevent extreme fluctuations in the exchange rate. The exchange rate is managed through changes in the interest rate to attract/detract capital flows or through the buying and selling of the currency. This system is contrasted with a Pure Float in which there is no central bank intervention and the exchange rate is entirely determined by the market and speculation.

E

Economic Exposure
When the cash flow of a country is vulnerable to changes in the exchange rate.

Efficient Markets
Markets where assets are traded in which the price is indicative of all current and relevant information and thus it is impossible to have undervalued assets.

End of the Day (Mark to Market)
Accounting measure, referring to the way traders record their positions. There are two ways that a trader can record his positions: the accrual system in which only cash flows are recorded and the mark to market method, in which the value of an asset is recorded at the end of each trading day at the closing rate or value.

Estimated Annual Income
The expected yearly earnings.

Euro
The new monetary unit of the European Monetary Union used by twelve countries in the European Union. It is now the legal tender of those countries as of January 2002. Those countries include Germany, France, Belgium, The Netherlands, Luxembourg, Spain, Portugal, Italy, Austria, Ireland, Finland and Greece.

European Monetary Union
An institution of the EU, whose primary goal is to establish a single currency (the euro) for the entire EU.

F

FCM
See Futures Commission Merchant.

Federal Deposit Insurance Corporation
A regulatory agency of the created to oversee that bank deposits are insured against bank failures. It was created in 1933 to restore confidence in the banking system. It insures up to US $100,000 per banking institution.

Federal Reserve/Fed
The central bank of the United States, responsible for monetary policy.

Fixed Exchange Rate
When the exchange rate of a currency is not allowed to fluctuate against another, i.e. the exchange rate remains constant. Typically, under fixed exchange rate regimes, currencies are allowed to fluctuate within a small margin. Fixed exchange rate regimes require central bank intervention to maintain the fixed rate.

Fixed Interest Rate
An interest rate used for loans, mortgages and bonds that remain at the same rate throughout the period.

Flat/Square
To either have no positions or positions that cancel each other out.

Floating Rate Interest
An interest rate that is allowed to adjust with the market. The opposite of a fixed interest rate.

Foreign Exchange (Forex)
The buying and selling of currencies.

Foreign Currency Effect
Refers to how changes in the exchange rate affect the return on foreign investment.

Forward Contract
A deal in which the price for the future delivery of a commodity is set in advance of the delivery. The Forward rate is obtained by adding the margin to the spot rate. It is used to hedge against adverse fluctuations in the exchange rate that can affect amount of profit or loss at that future date.

Forward Points
Refers to the pips that were added to or subtracted from the current exchange rate to obtain the forward price/rate.

Future Rate Agreements (FRAs)
FRAs are agreements that are made that allow for borrowing and lending at a constant interest rate for a specified period in the future.

Front Office
Refers to the sales personnel (trading and other business personnel) in a financial company.

Fundamental Analysis
The analysis of economic indicators and political and current events that could effect the future direction of financial markets.

Futures Commission Merchant
A Futures Commission Merchant engages in futures and options transactions. An FCM has a role in the futures market that is similar to that of a broker in the securities market.

Futures (Financial Futures)
Future contracts that commit both sides to an exchange/transaction of financial instruments, currencies or commodities at a future date and a predetermined price. Future contracts are similar to forward contacts, but future contracts can be traded in the futures markets. Can be used to hedge or speculate against the value of the asset at the expiry date.

G

GTC (Good-till-Cancelled)
Refers to an order given by an investor to a dealer to buy or sell a security at a fixed price that is considered “good” until the investor cancels it.

H

Hedge/Hedging
Strategy to reduce the risk of adverse price movements on one's portfolio and to protect against the volatility of the market. Hedging typically involves selling the good forward or taking a position in a related security. Hedging becomes more prevalent with increased uncertainty about current market conditions.

High/Low
Refers to the daily traded high and low price.

I

Inflation
Refers to the increase in prices (price level) and wages over time that decrease purchasing power. It is calculated from changes in the price index, usually a consumer price index or a GDP deflator.

Initial Margin
The percentage of the price of a security that is required for the initial deposit to enter into a position. The Federal Reserve Board requires a minimum of 50% initial margin. For futures contracts, the market determines the initial margin.

Interbank Rate
The rate at which the major banks (Deutsche, Citibank, Bank of Tokyo) trade in foreign exchange.

Interest-Rate Swaps
The process of changing the form of debts held by banks or companies, in which they trade debts/loans fixed rates for floating rates (or vice versa) in another country.

Interest-Rate Swap Points
The interest rate can be determined through the difference in the bid and offer price of an exchange rate. If you are looking at the EUR/USD exchange rate and the offer price is higher than the bid price, than Europe's interest rates are higher than US interest rates.

ISDA (International Swaps and Derivatives Association)
Organization defining the terms and conditions for trade in derivatives.

L

Leading Indicators
Such statistics as unemployment rates, CPI, Federal Funds Rate, retail sales, personal income, discount rate and the prime rate that are used to predict economic activity.

LIBO
Stands for the London Interbank Offer Rate, and is the rate at which major international banks lend to one another. It is widely used as the benchmark for short-term interest rates.

LIFFE
London International Financial Futures Exchange, made up of the three largest future exchanges in the UK.

Limit Order
An order with restrictions on the maximum price to be paid or the minimum price to be received. As an example, if the current price of USD/YEN is 102.00/05, then a limit order to buy USD would be at a price below 102. (ie 101.50)

Liquid Assets
Those assets, usually short dated assets like Treasury Bills that can easily be turned into money.

Liquidation
The process of closing out long or short positions by offsetting transactions. Also refers to the process of selling all assets of a bankrupt company to pay off first creditors and then shareholders.

Liquidity
The ability of a market to accept large transaction with minimal to no impact on price stability

Long (Position)
Refers to the ownership of securities, commodities or currencies, in which there is no intent to sell due to speculation that the price will rise.

M

Margin
A percentage of the total value of a transaction that a trader is required to deposit as collateral. Buying on margin refers to investing with borrowed funds, and the margin requirement insures against heavy losses.

Margin Call
This is a call by a broker or dealer to raise the margin requirement of an account. The call is typically made after the value of a security (securities) has significantly declined in value.

Market Maker
A broker-dealer firm that owns shares of a security and is willing to buy and sell at the quoted bid and ask prices. The firm lists buy and sell prices to attract customers.

Market Order
An order to buy or sell a stock at the best available price.

Market Risk
The risk associated with investing in the market and cannot be hedged or avoided.

Maturity
The date that the security is due to be redeemed or repaid.

Mine and Yours
Terms used to signal when a trader wants to buy (mine) and sell (yours).

Money Market
Highly liquid markets for short-term investing in monetary instruments and debts, typically maturing in less than one year. Because of large transaction cost relative to potential interest, transactions occur in large amounts and thus participants are mainly banks and other large financial institutions.

N

Net Worth
The difference between the values of assets and liabilities. For public companies this is referred to as shareholder equity.

O

Off-Balance Sheet
Financing or the raising of money by a company that does not appear on the company's balance sheet, such as Interest Rate Swaps and Forward Rate Agreements.

Offer
The price (or rate) at which a seller is willing to sell at.

Offsetting Transaction
When a trader enters an equivalent but opposite position to an already existing position, thereby balancing his positions. An offsetting transaction to an initial purchase would be a sale.

One Cancels Other Order (O.C.O. Order)
An order that through its execution cancels the other part of the same order.

Open/Open Position
An order that has yet to be executed and is still valid. An open position puts a trader at risk if the market prices rise or fall, i.e. the trader is vulnerable to movements in the exchange rate.

Open Order
An order to buy or sell that remains valid until it is executed or canceled by the customer. An order that is executed when the price of a share or currency reaches a predetermined price.

Options
These are tradable contracts giving the right, but not obligation, to buy or sell commodities, securities or currencies at a future date and at a prearranged price. Options are used to hedge against adverse price movements or to speculate against price rises or falls. Holding options is riskier than holding shares, but offer potentially higher returns.

Order
An instruction by a customer to a broker/trader to buy or sell at certain price or market price. The order remains valid until executed or cancelled by the customer.

Overnight
A position that remains open until the start of the next business day.

Over-the-Counter Market
A market not regulated by a stock exchange, such as the United States' NASDAQ. Over-the-counter refers to a stock not traded on an exchange, typically resulting from the company's inability to meet the requirements. Over-the-counter security transactions are made directly between brokers.

P

Pegging
When a country fixes the exchange rate to another country's currency, usually to achieve price stability. Most countries that peg their currencies do so against the US dollar or the Euro.

Pip (Points)
The smallest amount an exchange rate can move, typically .0001.

Political Business Cycle
A theory that explains changes in the economy as a result of political tactics before and after elections. To gain voter support politicians will often expand the economy prior to elections and implement reforms just after the elections to avoid punishment by the polity.

Political Risk
Risk that changes in government policies will negatively impact an investor. Political Risk is especially prevalent in third world countries.

Position
The amount of currency or security owned or owed by an investor.

Premium
The amount added to the spot price of a currency to get the forward or future price.

Price Transparency
Refers to the degree of access to information regarding bids and offers and respective prices. Ideally, every investor/trader would have equal access to all information.

Q

Quote
The offer price of a security.

R

Rate
The price of one currency in terms of another (exchange rate).

Realized and Unrealized Profit
Unrealized profit is a gain from an increase in the price of an asset that has not been cashed in. Realized profits are made from the cashing in of the unrealized gain.

Repurchase (REPO)
Repos are short-term money market instruments. The trader sells a security (government security) and buys it back only after a short period of time, typically only overnight. Repos are primarily used to raise short-term capital.

Resistance
A price level at which most investors expect prices to decline further. A price at which there is sufficient supply to turn a previously uptrend downward. With regards to the forex market, it is the level at which a currency cannot rise above.

Revaluation Rates
The market rates that are used by traders in the evaluation of the gains and losses in their accounts each day.

Risks
Uncertainty in the possible outcomes of an action, i.e. possible returns on an investment. Risk is most commonly measured from the variance of possible outcomes. Higher risks are associated with higher rates of returns, typically in order to induce investment in riskier ventures.

Risk Capital
The capital that an investor does not need to maintain his/her living standard.

Risk Management
Term to describe when a trader will use analysis and other trading techniques to avoid substantial risks to his portfolio.

Rollover
Refers to a process of reinvesting in which, at the expiry, the settlement is postponed until a later date. The cost of the process is measured by the interest rate differential between the two currencies.

S

Settlement
The actual finalization of a contract in which the goods, securities or currencies are paid for or delivered and the transaction is entered in the books.

Short
The selling of a borrowed security, commodity or currency. Traders sell when prices are expected to fall.

Short Position
A contract to sell securities, commodities or currencies at a future date and at a prearranged price. At the expiry date, if the spot price is below the contract price, the holder of the contract will make a profit and if the spot price is above the contract price, then there is the potential to make a huge loss.

Spot Market
A market in which commodities, securities or currencies are immediately delivered.

Spot Price
The current market price.

Spread
The difference between the bid and offer price that is offered by a market maker.

Sterling
Refers to the currency, the Pound.

Stop Order (Stop-Loss Order)
An order used to hedge against excessive loss in which a position is liquidated at a specific, prearranged price.

Support
A price level at which there is sufficient demand to turn a downtrend up.

Swap
When a trader exchanges one currency for another, holding it for only a short period. Swaps are typically used to speculate on interest rate movements. It is calculated using the interest differentials between the two currencies.

Swap Spread
The difference between the negotiated and fixed price of the swap. The size of the spread depends on market supply and participating parties' credit.

T

Technical Analysis
A technique used to try and predict future movements of a security, commodity or currency, based solely on past price movements and volume levels. It examines charts and historical performance.

Tick
A minimum price movement.

Ticker
Depicts current or recent history of a currency, usually in the form of a graph or chart.

Trade Price Response
This term advises that price reaction to a certain level is critical. If this level breaks then the recommendation would be to run with the market direction (i.e. Buy a break above resistance level; sell a break below a support level). However, if a price stalls at this level and is rejected then the recommendation is to go with this also (i.e. Sell at a resistance level that is tested and holds, buy at a support level).

Transaction Costs
The costs that are incurred by a trader when buying or selling currencies, commodities, or currencies. These costs include broker commissions or spreads.

Transaction Date
The date a trade occurs.

Turnover
The number or volume of shares traded over a specific time period. The larger the turnover, the more commissions a broker will be making.

Two Way Price
A price that includes both the bid and offer price. The NASD requires that market makers have both bid and ask prices for any security, currency or commodity in which they make a market. This is called a two-sided market.

U

Uptick
A price quote that is higher than the preceding quote for the same currency.

Uptick Rule
A regulation requiring that if a security is to be traded short, the price in the trade prior to the short trade has to be lower than the price of the present short trade.

U.S. Prime Rate
The interest rate that the major banks lend to major clients.

V

Value Date
The date that payment is exchanged between two parties.

Variation Margin
A call by a broker to increase the margin requirement of an account during a period of extreme market volatility.

Variance
Measures the volatility of a data set/data points from the mean. It is calculated by adding the squares of the standard deviations from the mean and dividing by the number of data points, i.e. taking the average of the standard deviations.

Volatility
Refers to the tendency of prices/variables to fluctuate over time. It is most commonly measured using the coefficient of variation (the standard deviation divided by the mean). The higher the volatility, the higher the risk involved.

Volume
The number of shares or contracts traded for a certain security or an exchange during a period.

W

Warrant
It is a right but not obligation to buy shares in a company at a future date and at a prearranged price. Warrants are tradable options.

Whipsaw
Term used to describe sharp price movements and reversals in the market. A whipsaw would be if shortly after you bought a stock the price plummeted.

Y

Yard

Term for a billion JPY.