What is Forex?

The foreign exchange market is a decentralized, over-the-counter (OTC) global market. The daily volume of the Forex market surpasses $4 trillion as day worldwide. To put this in perspective the daily volume traded on the New York stock exchange is $25 billion making it the largest financial market in the world. The total Forex volume is well over three times the total amount of the stocks and futures markets combined.

The participants of the Forex market include banks, corporations, institutional investors, hedge funds and individuals. In simple terms Forex trading is where you can buy and sell currencies, simultaneously. The way it works is much like the process of currency exchange at airports or hotels where you can exchange the currency you deal with for the local currency. The Forex market is open 24 hours a day 5 days a week, enabling traders to buy and sell around the clock acting on global news events as they happen.

JP Markets allows individual traders the opportunity to access currency prices previously only available to large institutions and wealthy individuals.

History of the Forex Market

Foreign exchanges markets we first developed to facilitate cross border trade conducted in different currencies by government, companies and individuals. In the early days the foreign exchange markets primarily existed to facilitate the international movement of money, however even in the early days there were speculators.

These days a large portion of the Forex market is driven by speculation, arbitrage and professional dealing. In the past retail investors could only gain access to the foreign exchange market through banks that transact large amounts or currencies for commercial and investment purposes. Trading volume has increased rapidly over time, especially after exchange rates were allowed to float freely in 1971.

Throughout the 80s and 90s access to the Forex market was limited to banks, funds, commodity trading advisors (CTAs) managing large sums of money, large corporations and big investors. Access was afforded to this group as they were able to meet the strict credit guidelines established by banks that smaller investors were unable to meet.

As the Forex market grew, it gained increasing recognition as a means for individuals to speculate in global markets and in the early 2000's the online Forex trading market was born. Online Forex brokers establish the 'line of credit' with a bank, otherwise known as a prime brokerage agreement. This negates the need for individuals to have the deep pockets previously required for individuals to trade in the Forex market.

It has gained significantly in popularity since the global financial crisis as investors seek ways to diversify their portfolios and generate returns not correlated with traditional markets such as equities and real estate. Investors are drawn to the high volatility of the Forex market, benefiting from the ability to go long or short, generating leveraged returns in rising and falling market.

How does Forex Trading work?

Forex trading is similar to trading share or futures except that when trading forex you are buying or selling one currency against another. One of the key advantage forex trading has over other financial instruments is that relatively small lot sizes can be traded, lot sizes can be as small as 1000 units or one micro lot. Typically forex trading also involves leverage which in some cases can be as high as 1:500, this is very different to trading shares where no leverage is involved. Leverage allows traders to trade with more money than they actually have in their trading account, for example if you had 1:100 leverage you could use a $1,000 deposit to control $100,000 worth of currency. Using leverage can result in an increase in you gains however if not used correctly it can also result in increased losses.

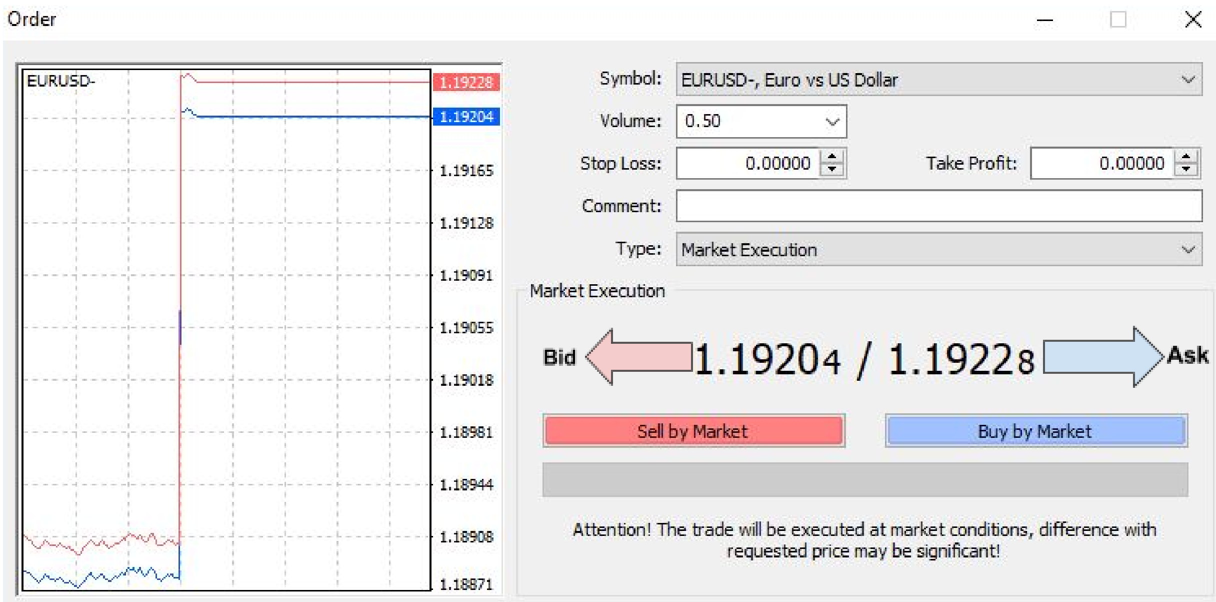
Forex Pricing

Every currency pair consists of a base currency and a term/quoted currency. The first currency in the pair is the base currency, the second is the quote or term currency.

As an example with the EURUSD currency pair

EUR = Base currency
USD = Term currency

Bid: the rate at which you can sell the base currency. This is the first rate on the deal ticket below (1.19204).
Ask (or offer): The rate at which you can buy the base currency. This is the second rate on the deal ticket and can be found on the right (1.19228).



Spreads

The spread of a currency pair is the difference between the bid and the ask rate.
JP Markets offers some of the tightest spreads of all Forex brokers globally, our spreads can be seen on our trading platform.

Pips

A pip represents the smallest increment that an exchange rate can move. One pip is 0.01 for currency pairs with JPY as the term currency and 0.0001 for all other pairs. JP Markets offers fractional pip pricing which represents a tenth of a pip. This is to improve the spread offered to clients and improve the precision with which they can trade.

Margins

Margin is the amount of money required in your account in order to open a position. Margin is calculated based on the current price of the base currency against USD, the size (volume) of the position and the leverage applied to your trading account. If you do not have sufficient free equity available you will be unable to open a position on the trading platform. The free margin amount shown in the trading platform is the amount you have available to use should you wish to open additional positions.

Common Order Types

The three main types use in forex are stops, limits and market orders. Depending on whether you want to be a buyer or seller, above or below or at the market price will determine which of the below orders you should be using.

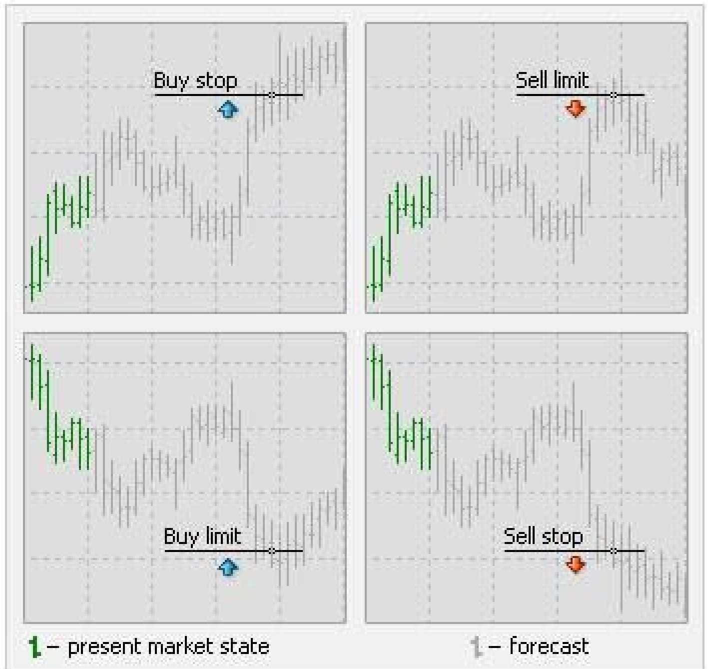
Buy Stop - buy order above the current market price

Sell Limit - sell order above the current market price

Market Execution - buy or sell order at the current market price

Buy Limit - buy order below the current market price

Sell Stop - sell order below the current market price



Stop orders are commonly used for breakout and momentum style strategies. They buy in a rise market and sell and a falling market. Traders will often place these orders above resistance or below support, trading a break of these levels.

Limit orders are used by range and countertrend traders. Limit orders sell into a rising market and buy into a falling market. Because of this they are preferred by more experienced traders who are able to place these order types at key resistance and support levels, picking market swing points.

Market orders are orders to buy at the current ask (offer) rate or sell at the current bid rate.

Stop loss orders are orders to close a position at a predefined level set by the trader. This would normally be at a loss. These are technically stop buy and stop sell orders.

Take profit orders are orders to close a position at a predefined level, normally at a profit. These orders are limit orders.

What influences buying and selling?

At the most basic level, the only thing that will ever move an exchange rate is the supply and demand for that particular currency at a given point in time. In other words, if a currency is to rally there will be excess demand in the market causing this increase in price. The opposite is true if a currency is to fall in value, there will be excess supply in this case.

Any speculative transaction in the Forex market is entered into on the premise that future exchange rates will move in such a direction that the position becomes profitable. The below points give reasons why participants may form a buy or sell bias based on their understanding of the future direction of exchange rates.

- Fundamentals – economic, social and political; data, reports and news that market participants can use to determine whether they want to be buyers or sellers of a currency. For example; investors chasing yield would invest in a currency pair with a wide interest rate differential such as the AUD/USD. This is known as the carry trade, where investors will borrow funds from a country with low interest rates and invest them in a country with higher rates.
- Geopolitical outlook for a county or region – assessing the economic and political stability of a country or region and using this assessment to determine whether an investment opportunity may arise. For example, shorting the USD against the majors during the Iraq war had two benefits; the declining fiscal situation of the US due to the ballooning costs of the war and declining investor confidence
- Trade flows – importers and exporters buying and selling currencies to make and receive payments for the goods and services they deal in. For example; Japanese companies selling their cars to US will require at some point a conversion from Dollars to Yen. This will increase the demand for the Yen potentially causing it to strengthen.
- Capital flows – speculative and investment flows into and out of a currency to take advantage of higher yields, equity markets, portfolio investments and Mergers and acquisitions.
- Technical analysis – the study of price on charts to make trading decisions. Technical indicators and analysis can give entry and exit signals for tor trades.
- Market sentiment and climate – this can be anything from the investor confidence and the attitude of the market to risk, to the liquidity in the market.

Forex Terminology?

Below are some of the more frequently asked questions relating to commonly used forex terminology traders ask before starting to trade forex.

What does the term 'Spread' mean?
Spread is the difference between the BID and the ASK price of a currency pair.

How many decimal places does JP Markets quote to?
JP Markets quotes all currency pairs to 5 decimal places. A pair quoted in 5 decimal places would appear as 0.00010 on the trading platform.

For example: If the AUD/USD moves from 1.04054 to 1.04064, the 0.00010 USD move higher represents a one pip move.

What is Hedging?
Hedging is when a new position is opened in the opposite direction of an existing position on the same currency pair.

For example: In order to hedge a long position of 1 lot on EUR/USD, you would need to sell a 1 lot position also.

Hedging does not require any additional margin but in fact reduces the overall margin on the position as the positions now offset each other.

What is Leverage?
Leverage give you the ability to open a larger position than you would otherwise be able to. JP Markets offers a maximum leverage of 500:1, this means for every $1 that you have in your trading account you are able to open a position worth $500.

Leverage offers traders the ability to make larger profits from small price movements, and, at the same time, risk only minimal capital on a position.

It is however important to note that although leverage can substantially increase your profits it can also substantially increase your losses as well, it is for this reason you should have a good risk management strategy in place.

What is a Margin Call?
A margin call occurs when the balance of your account is not sufficient to be able to maintain the margin on your current open positions. If the market moves against you, you will need to deposit additional funds into your trading account to maintain your open positions or run the risk of your positions being automatically closed, this is known as ‘liquidation’. Your positions can be liquidated without warning so it is important to maintain sufficient margin in your account at all times to avoid this from happening.