



## Forex Basics

As discussed, all clients of United Mutual must qualify as **Wholesale**, and as such are assumed to have a good understanding of FX Markets and how they work, along with the use and consequences of margin and leverage.

However, it never hurts to 'brush up', and we've therefore produced this document which summarizes the basics of Forex trading.

Please note, United Mutual does NOT trade the 'traditional' way, and as such many of the topics and comments following are not applicable to our trading. When you read this document, keep in mind that our system and algorithm is unique in its application.

## **What is FOREX?**

The Foreign Exchange market - also referred to as "FOREX", "Forex", "Retail forex", "FX", "Spot FX" or just "Spot" - is the largest financial market in the world, with a volume of over \$4 trillion a day. If you compare that to the \$25 billion a day volume that the New York Stock Exchange trades, you can easily see how enormous the Foreign Exchange really is. It equates to more than three times the total amount of the stocks and futures markets combined!

## **What is traded on the Foreign Exchange market?**

The simple answer is money. Forex trading is the simultaneous buying of one currency and the selling of another. Currencies are traded through a broker or dealer, and are traded in pairs; for example the euro and the US dollar (EUR/USD) or the British pound and the Japanese Yen (GBP/JPY).

Because you're not buying anything physical, this kind of trading can be confusing. Think of buying a currency as buying a share in a particular country. When you buy the Japanese Yen, you are in effect buying a share in the Japanese economy, as the price of the currency is a direct reflection of what the market thinks about the current and future health of the Japanese economy.

**In general, the exchange rate of a currency versus other currencies is a reflection of the condition of that country's economy, compared to the other countries' economies.**

Unlike other financial markets like the New York Stock Exchange or the ASX, the Forex spot market has neither a physical location nor a central exchange. The Forex market is considered an Over-the-Counter (OTC) or 'Interbank' market, due to the fact that the entire market is run electronically, within a network of banks, continuously over a 24-hour period.

Until the late 1990's, only the "big guys" could play this game. The initial requirement was that you could trade only if you had about ten to fifty million bucks to start with. Forex was originally intended to be used by bankers, large institutions, and commercial accounts only. However, because of the rise of the Internet, online Forex trading firms are now able to offer trading accounts to smaller traders like us.

However, the reality is to trade FX with adequate risk management, a large account is still required. Despite many websites, brokers and 'education' companies telling you otherwise, trading FX the traditional way – that is, trying to pick the direction correctly – is as close to a certain way to lose money as there is.

In theory, all you need to get started is a computer and a high-speed Internet connection, but that is rarely enough to be profitable with trading.

This document was created to provide a basic overview to all the essential aspects of foreign exchange, in an easy-to-understand manner.

### What is a Spot Market?

A spot market is any market that deals in the **current price** of a financial instrument.

### Which Currencies Are Traded?

The most popular currencies along with their symbols are shown below:

Symbol	Country	Currency	Nickname
USD	United States	Dollar	Buck
EUR	Euro members	Euro	Fiber
JPY	Japan	Yen	Yen
GBP	Great Britain	Pound	Cable
CHF	Switzerland	Franc	Swissy
CAD	Canada	Dollar	Loonie
AUD	Australia	Dollar	Aussie
NZD	New Zealand	Dollar	Kiwi

Forex currency symbols are always three letters, where the first two letters identify the name of the country and the third letter identifies the name of that country's currency.

### When Can Currencies Be Traded?

The spot FX market is unique within the world markets, in that it is open 24-hours a day. At any time, somewhere around the world a financial center is open for business, and banks and other institutions exchange currencies every hour of the day and night with generally only minor gaps on the weekend.

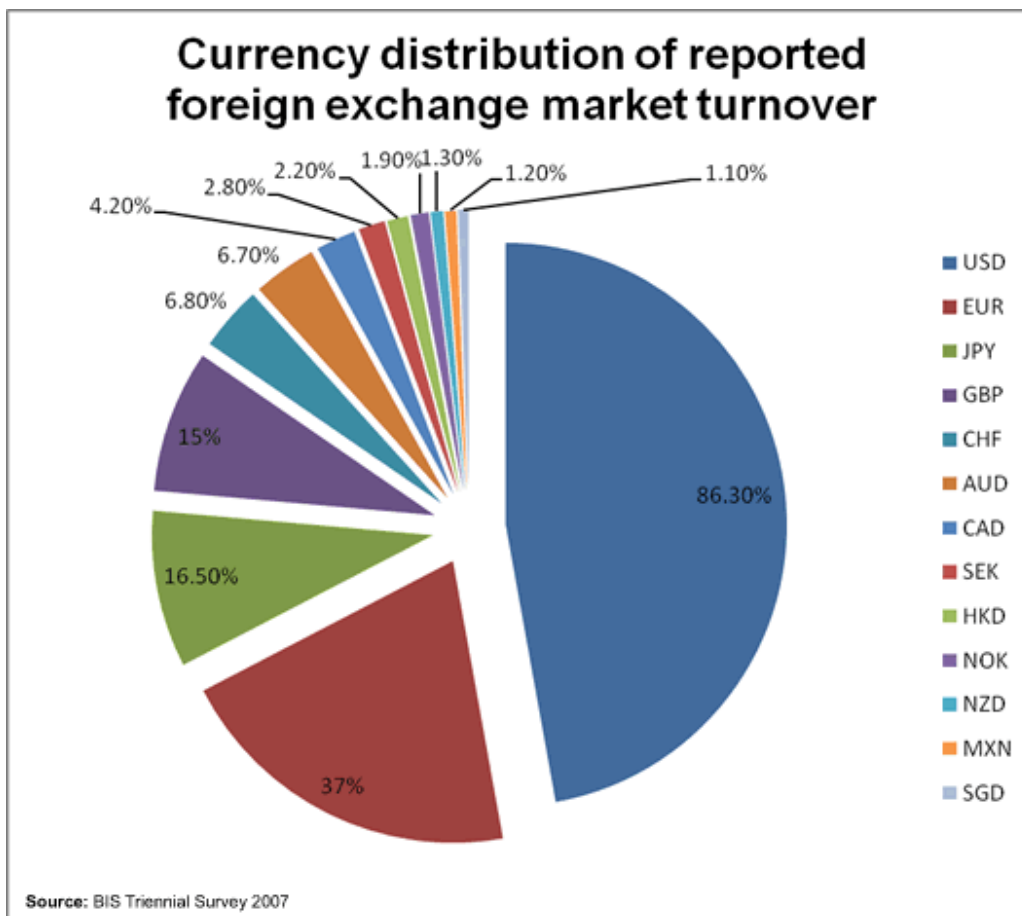
The foreign exchange markets follow the sun around the world, so you can trade late at night or in the morning.

Time Zone	New York	GMT
Tokyo Open	7:00 pm	0:00
Tokyo Close	4:00 am	9:00
London Open	3:00 am	8:00
London Close	12:00 pm	17:00
New York Open	8:00 am	13:00
New York Close	5:00 pm	22:00

## The Forex market (OTC)

The Forex OTC market is by far the biggest and most popular financial market in the world, traded globally by a large number of individuals and organizations. In the OTC market, participants determine their counterparty depending on trading conditions, attractiveness of prices and reputation of the trading counterpart.

The chart below shows global foreign exchange activity. The US dollar is the most traded currency, being involved in 86% of all transactions. The euro's share is second at 37%, while that of the yen is third at 16.5%.



## Why Trade Foreign Currencies?

There are many benefits and advantages to trading Forex. Here are just a few reasons why so many people are choosing this market:

- **No commissions.**  
No clearing fees, no exchange fees, no government fees, no brokerage fees. Brokers are compensated for their services through something called the bid-ask spread.

- **No middlemen.** Spot currency trading eliminates the middlemen, and allows you to trade directly with the market responsible for the pricing on a particular currency pair.
- **No fixed lot size.**  
In the futures markets, lot or contract sizes are determined by the exchanges. A standard-size contract for silver futures is 5000 ounces. In spot Forex, you determine your own lot size. This allows traders to participate with accounts as small as \$250 (although we explain later why a \$250 account is a bad idea).
- **Low transaction costs.**  
The retail transaction cost (the bid/ask spread) is typically less than 0.1 percent under normal market conditions.
- **A 24-hour market.**  
There is no waiting for the opening bell - from Monday Morning AEST to Saturday morning, the Forex market never sleeps.
- **No one can corner the market.**  
The foreign exchange market is so huge and has so many participants that no single entity (not even a central bank) can control the market price for an extended period of time.
- **Leverage.**  
In Forex trading, a small margin deposit can control a much larger total contract value. Leverage gives the trader the ability to make nice profits, and at the same time keep risk capital to a minimum. Without proper risk management, this high degree of leverage can lead to large losses as well as gains.
- **High Liquidity.**  
Because the Forex Market is so enormous, it is also extremely liquid. This means that under normal market conditions, with a click of a mouse you can instantaneously buy and sell at will. You are never "stuck" in a trade. We can set an online trading platform to automatically close a position at a desired profit level (a limit order).
- **"Mini" and "Micro" Trading:**  
You would think that getting started as a currency trader would cost a ton of money. The fact is, compared to trading stocks, options or futures, it doesn't. Online Forex brokers offer "mini" and "micro" trading accounts, some with a minimum account deposit of \$300 or less. We are definitely not saying you *should* open an account with the bare minimum – you definitely should NOT - but it does makes Forex much more accessible to the average individual who doesn't have a lot of start-up trading capital.

## How You Make Money Trading Forex

In the FX market, you buy or sell currencies. Placing a trade in the foreign exchange market is simple: the mechanics of a trade are very similar to those found in other markets (like the stock market), so if you have any experience in trading, you should be able to pick it up pretty quickly.

The object of Forex trading is to exchange one currency for another in the expectation that the price will change, so that the currency you bought will increase in value compared to the one you sold.

### Example of making money by buying euros

Trader's Action	EUR	USD
You purchase 10,000 euros at the EUR/USD exchange rate of 1.18	+10,000	-11,800*
Two weeks later, you exchange your 10,000 euros back into US dollars at the exchange rate of 1.2500.	-10,000	+12,500**
You earn a <b>profit of \$700.</b>	0	<b>+700</b>

\*EUR 10,000 x 1.18 = US \$11,800

\*\* EUR 10,000 x 1.25 = US \$12,500

An exchange rate is simply the ratio of one currency valued against another currency. For example, the USD/CHF exchange rate indicates how many US dollars can purchase one Swiss franc, or how many Swiss francs you need to buy one US dollar.

### How to Read an FX Quote

Currencies are always quoted in pairs, such as GBP/USD or USD/JPY. The reason they are quoted in pairs is because in every foreign exchange transaction you are simultaneously buying one currency and selling another. Here is an example of a foreign exchange rate for the British pound versus the US dollar:

**GBP/USD = 1.7500**

The first listed currency to the left of the slash ("/") is known as the **base currency** (in this example, the British pound), while the second one on the right is called the **counter or quote currency** (in this example, the US dollar).

When buying, the exchange rate tells you how much you have to pay in units of the quote currency to buy one unit of the base currency. In the example above, you have to pay 1.7500 US dollar to buy 1 British pound.

When selling, the exchange rate tells you how many units of the quote currency you get for selling one unit of the base currency. In the example above, you will receive 1.7500 US dollars when you sell 1 British pound.

**The base currency is the “basis” for the buy or the sell.** If you buy EUR/USD this simply means that you are buying the base currency (the 1<sup>st</sup> one in the pair) and simultaneously selling the quote currency (the 2<sup>nd</sup>).

You would **buy** the pair if you believe the base currency will appreciate (go up) relative to the quote currency. You would **sell** the pair if you think the base currency will depreciate (go down) relative to the quote currency.

### Long/Short

First, you should determine whether you want to buy or sell.

If you want to buy (which actually means buy the base currency and sell the quote currency), you want the base currency to rise in value and then you would sell it back at a higher price. In trader's talk, this is called "going long" or taking a "long position". Just remember: **long = buy**.

If you want to sell (which actually means sell the base currency and buy the quote currency), you want the base currency to fall in value and then you would buy it back at a lower price. This is called "going short" or taking a "short position". **Short = sell**.

### Bid/Ask Spread

All Forex quotes include a two-way price, the **bid** and **ask**. The bid is always lower than the ask price.

The **bid** is the price in which the dealer is willing to buy the base currency in exchange for the quote currency. This means the bid is the price at which you (as the trader) will sell.

The **ask** is the price at which the dealer will sell the base currency in exchange for the quote currency. This means the ask is the price at which you will buy.

The difference between the bid and the ask price is popularly known as the **spread**.

Let's take a look at an example of a price quote taken from a trading platform:



GBP/USD	
Bid	Ask
1.7445	1.7449
Sell	Buy

On this GBP/USD quote, the bid price is 1.7445 and the ask price is 1.7449. Look at how this broker makes it so easy for you to trade away your money.

If you want to sell GBP, you click "Sell" and you will sell pounds at 1.7445. If you want to buy GBP, you click "Buy" and you will buy pounds at 1.7449.

Remember that at United Mutual we do **not** use any type of analysis to guess at the future direction, and we don't care what is happening to the economies of the currencies we trade. We do NOT try to pick direction – to be honest we believe that is virtually impossible for anyone to do successfully over a long time period. You may get lucky from time to time, but we know of zero successful traders who consistently turn a profit from this type of trading.

However, this is the 'traditional' way to invest, and so to help us explain the basics of FX, we will use what is known as 'fundamental analysis' in the following examples. That is, taking a position based on the fundamental strength of either currencies economies.

### EUR/USD

In this example Euro is the base currency and thus the "basis" for the buy/sell.

If you believe that the US economy will continue to weaken, which is bad for the US dollar, you would execute a **BUY** EUR/USD order. By doing so you have bought euros in the expectation that they will *rise* versus the US dollar.

If you believe that the US economy is strong and the euro will weaken against the US dollar you would execute a **SELL** EUR/USD order. By doing so you have sold Euros in the expectation that they will *fall* versus the US dollar.

### USD/JPY

In this example the US dollar is the base currency and thus the "basis" for the buy/sell.

If you think that the Japanese government is going to weaken the Yen in order to help its export industry, you would execute a **BUY** USD/JPY order. By doing so you have bought U.S dollars in the expectation that they will rise versus the Japanese yen.

If you believe that Japanese investors are pulling money out of US financial markets and converting all their US dollars back to Yen, and this will hurt the US dollar, you would execute a **SELL USD/JPY** order. By doing so you have sold U.S dollars in the expectation that they will depreciate against the Japanese yen.

### **GBP/USD**

In this example the GBP is the base currency and thus the “basis” for the buy/sell.

If you think the British economy will continue to do better than the United States in terms of economic growth, you would execute a **BUY GBP/USD** order. By doing so you have bought pounds in the expectation that they will rise versus the US dollar.

If you believe the British's economy is slowing while the United State's economy remains strong like bull, you would execute a **SELL GBP/USD** order. By doing so you have sold pounds in the expectation that they will depreciate against the US dollar.

### **USD/CHF**

In this example the USD is the base currency and thus the “basis” for the buy/sell.

If you think the Swiss franc is overvalued, you would execute a **BUY USD/CHF** order. By doing so you have bought US dollars in the expectation that they will appreciate versus the Swiss Franc.

If you believe that the US housing market bubble burst will hurt future economic growth, which will weaken the dollar, you would execute a **SELL USD/CHF** order. By doing so you have sold US dollars in the expectation that they will depreciate against the Swiss franc.

### **I don't have enough money to buy 10,000 euros. Can I still trade?**

You can with margin trading. Margin trading is simply the term used for trading with borrowed capital. This is how you're able to open \$10,000 or \$100,000 positions with as little as \$50 or \$1,000. You can conduct relatively large transactions, very quickly and cheaply, with a small amount of initial capital.

Margin trading in the foreign exchange market is quantified in “lots”. We will be discussing these in depth later. For now, just think of the term "lot" as the minimum amount of currency you have to buy. When you go to the grocery store and want to buy an egg, you can't just buy a single egg; they come in dozens or "lots" of 12. In Forex, it would be just as foolish to buy or sell 1 euro, so they usually come in "lots" of 1,000 (Micro), 10,000 (Mini) or 100,000 (Standard) depending on the type of account you have.

### **For Example:**

- You believe that signals in the market are indicating that the British Pound will go up against the US dollar.

- You open one lot (100,000), buying with the British pound at 1% margin and wait for the exchange rate to climb. When you buy one lot (100,000) of GBP/USD at a price of 1.5000, you are buying 100,000 pounds, which is worth US\$150,000 (100,000 units of GBP \* 1.50 (exchange rate with USD)). If the margin requirement was 1%, then US\$1500 would be set aside in your account to open up the trade (US\$150,000 \* 1%). You now control 100,000 pounds with US\$1500. Your predictions come true and you decide to sell.
- You close the position at 1.5050. You earn 50 pips or about \$500. (A pip is the smallest price movement available in a currency).

<b>Your Actions</b>	<b>GBP</b>	<b>USD</b>
You buy 100,000 pounds at the GBP/USD exchange rate of <b>1.5000</b>	+100,000	-150,000
You blink for two seconds and the GBP/USD exchange rate rises to <b>1.5050</b> and you sell.	-100,000	+150,500**
You have earned a <b>profit of \$500.</b>	0	<b>+500</b>

When you decide to close a position, the deposit that you originally made is returned to you and a calculation of your profits or losses is done. This profit or loss is then credited to your account.

We will also be discussing margin more in-depth in the next lesson, but hopefully you're able to get a basic idea of how margin works.

### **Rollover**

For positions open at your broker's "cut-off time", there is a daily rollover interest rate that a trader either pays or earns, depending on your established margin and position in the market.

Since every currency trade involves borrowing one currency to buy another, interest rollover charges are part of forex trading.

Interest is paid on the currency that is borrowed, and earned on the one that is bought.

If a client is buying a currency with a higher interest rate than the one he/she is borrowing, the net differential will be positive (i.e. USD/JPY) - and the client will earn funds as a result. Ask your broker or dealer about specific details regarding rollover.

Also note that many retail brokers do adjust their rollover rates based on different factors (e.g., account leverage, interbank lending rates). Please check with your broker for more information on rollover rates and crediting/debiting procedures.

## PIPS and Lots

Here is where we're going to do a little math. You've probably heard of the terms "pips" and "lots" thrown around, and here we're going to explain what they are and show you how they are calculated.

### What is a PIP?

The most common increment of currencies is the PIP. A PIP is actually the smallest amount a currency can move.

For all currency pairs outside of the Yen, a PIP is the 4<sup>th</sup> decimal place in the quote. If the EUR/USD moves from 1.2250 to 1.2251, that is ONE PIP.

If the AUD/USD moves from 96.3452 to 96.3454, it has moved 2 PIPS.

With the currency pairs that include the Japanese Yen, a PIP is the 2<sup>nd</sup> decimal place. In the case of the USD/JPY moving from 119.80 to 119.85, that's 5 PIPS.

The PIP is how you measure your profit or loss.

As each currency has its own value, it is necessary to calculate the value of a pip for that particular currency.

### What is a Lot?

Spot Forex is traded in lots. The standard size for a lot is 100,000 units. There is also a mini lot size and that is 10,000 units, and some brokers allow a micro lot, which is 1,000 units.

As you already know, currencies are measured in pips, which is the smallest increment of that currency. To take advantage of these tiny increments, you need to trade large amounts of a particular currency in order to see any significant profit or loss.

Let's assume we will be using a 100,000 unit (standard) lot size. We will now calculate some examples to see how it affects the pip value.

USD/CHF at an exchange rate of 1.4555  
 $(.0001 / 1.4555) \times 100,000 = \text{US}\$6.87$  per pip

USD/JPY at an exchange rate of 119.80  
 $(.01 / 119.80) \times 100,000 = \text{US}\$8.34$  per pip

In cases where the US Dollar is not quoted first, the formula is slightly different (if you want to convert it to a USD PIP value, that is).

EUR/USD at an exchange rate of 1.1930  
 $(.0001 / 1.1930) \times 100,000 = \text{€}8.38$

To convert that to USD, multiply by the rate of 1.1930 = \$9.99734 rounded up will be US\$10 per pip

GBP/USD at an exchange rate of 1.8040  
 $(.0001 / 1.8040) \times 100,000 = \text{£}5.54$ ,  $\times 1.8040 = 9.99416$  rounded up will be US\$10 per pip.

As the market moves, so will the pip value depending on what currency you are currently trading.

### **How do I calculate profit and loss?**

So now that you know how to calculate pip value, let's look at how you calculate your profit or loss.

Let's buy US dollars (USD) and Sell Swiss Francs (CHF).

The rate you are quoted is 1.4525 / 1.4530. Because you are buying US you will be working on the 1.4530, the rate at which traders are prepared to sell.

So you buy 1 standard lot (100,000 units) at 1.4530.

A few hours later, the price moves to 1.4550 and you decide to close your trade.

The new quote for USD/CHF is 1.4550 / 1.4555. Since you're closing your trade and you initially bought to enter the trade, you now sell in order to close the trade so you must take the 1.4550 price. The price traders are prepared to buy at.

The difference between 1.4530 and 1.4550 is .0020 or 20 pips.

Using our formula from before, we now have  $(.0001/1.4550) \times 100,000 = \text{US}\$6.87$  per pip  $\times 20$  pips = US\$137.40

Remember, when you enter or exit a trade, you are subject to the spread in the bid/offer quote.

**When you buy a currency you will use the offer price and when you sell you will use the bid price.**

So when you **buy** a currency, you pay the spread as you **enter** the trade but not as you exit. And when you **sell** a currency you don't pay the spread when you enter but only when you **exit**.

### **What is Leverage?**

You are probably wondering how a small investor like yourself can trade such large amounts of money. Think of your broker as a bank who basically fronts you \$100,000 to buy currencies and all he asks from you is that you give him \$1,000 as a good faith deposit, which he will hold you for but not necessarily keep. Sounds too good to be true? Well this is how forex trading using leverage works.

The amount of leverage you use will depend on your broker and what you feel comfortable with.

Typically the broker will require a trade deposit, also known as **margin**. Once you have deposited your money you will then be able to trade. The broker will also specify how much they require per position (lot) traded.

For example, if the leverage is 100:1 (or 1% of position required), and you wanted to trade a position worth \$100,000, your broker would set aside \$1,000, or the "margin". So if you have \$5,000 they may allow you to trade up to \$500,000 of Forex.

The minimum security (margin) for each lot will vary from broker to broker. In the example above, the broker required a one percent margin. This means that for every \$100,000 traded, the broker wants \$1,000 as a deposit on the position.

### **What is a Margin Call?**

In the event that money in your account falls below margin requirements (usable margin), your broker will close some or all open positions. This prevents your account from falling into a negative balance, even in a highly volatile, fast moving market.

#### **Example #1**

Let's say you open a regular Forex account with \$2,000 (not a smart idea!). You open 1 standard lot (100,000 units) of the EUR/USD, with a margin requirement of \$1000. Usable Margin is the money available to open new positions or sustain trading losses. Since you started with \$2,000, your usable margin is \$2,000. But when you opened 1 lot, which requires a margin requirement of \$1,000, your usable margin is now \$1,000.

If your losses exceed your usable margin of \$1,000 you will get a margin call, and either need to add more funds or close the position.

#### **Example #2**

Let's say you open a regular Forex account with \$10,000 (still not a smart idea!). You open 1

standard lot of the EUR/USD, with a margin requirement is \$1000. Remember, usable margin is the money you have available to open new positions or sustain trading losses. So prior to opening 1 lot, you have a usable margin of \$10,000. After you open the trade, you now have \$9,000 usable margin and \$1,000 of used margin.

If your losses exceed your usable margin of \$9,000, you will get a margin call.

Make sure you know the difference between **usable margin** and **used margin**.

If the equity (the value of your account) falls below your usable margin due to trading losses, you will either have to deposit more money or your broker will close your position to limit your risk and his risk. As a result, you can never lose more than you deposit.

The topic of margin is a touchy subject and some argue that too much margin is dangerous. It all depends on the individual, and importantly how the margin is managed. The important thing to remember is that you thoroughly understand your broker's policies regarding margin and that you understand and are comfortable with the risks involved.

Some brokers describe their leveraging in terms of a leverage ratio and other in terms of a margin percentage. The simple relationship between the two terms is:

$$\text{Leverage} = 100 / \text{Margin Percent}$$

$$\text{Margin Percent} = 100 / \text{Leverage}$$

Leverage is conventionally displayed as a ratio, such 100:1 or 400:1.

# Placing Orders

The term "order" refers to how you will enter or exit a trade. Here we discuss the different types of orders that can be placed into the foreign exchange market. Be sure that you know which types of orders your broker accepts. Different brokers accept different types of orders.

## Order Types

### Basic Order Types

There are some basic order types that all brokers provide and some others that sound weird. The basic ones are:

- **Market order**  
A market order is an order to buy or sell at the current market price. For example, EUR/USD is currently trading at 1.2140. If you wanted to buy at this exact price, you would click buy and your trading platform would instantly execute a buy order at that exact price.
- **Limit order**  
A limit order is an order placed to buy or sell at a certain price. The order essentially contains two variables, price and duration. For example, EUR/USD is currently trading at 1.2050. You want to go long if the price reaches 1.2070. You can either sit in front of your monitor and wait for it to hit 1.2070 (at which point you would click a buy *market order*), or you can set a buy *limit order* at 1.2070 (then you could walk away from your computer to attend your ballroom dancing class). If the price goes up to 1.2070, your trading platform will automatically execute a buy order at that exact price. You specify the price at which you wish to buy/sell a certain currency pair and also specify how long you want the order to remain active (GTC or GFD).
- **Stop-loss order**  
A stop-loss order is a limit order linked to an open trade for the purpose of preventing additional losses if price goes against you. A stop-loss order remains in effect until the position is liquidated or you cancel the stop-loss order. For example, you went long (buy) EUR/USD at 1.2230. To limit your maximum loss, you set a stop-loss order at 1.2200. This means if you were dead wrong and EUR/USD drops to 1.2200 instead of moving up, your trading platform would automatically execute a sell order at 1.2200 and close out your position for a 30 pip loss. Stop-losses are extremely useful if you don't want to sit in front of your monitor all day worried that you will lose all your money. You can simply set a stop-loss order on any open positions so you won't miss your basket weaving class.

### Other Order Types

- **GTC (Good 'til canceled)**  
A GTC order remains active in the market until you decide to cancel it. Your broker will not cancel the order at any time. Therefore it's your responsibility to remember that you have the order scheduled.
- **GFD (Good for the day)**  
A GFD order remains active in the market until the end of the trading day. Because foreign

exchange is a 24-hour market, this usually means 5pm EST since that that's US markets close, but I'd recommend you double check with your broker.

- **OCO (Order cancels other)**

An OCO order is a mixture of two limit and/or stop-loss orders. Two orders with price and duration variables are placed above and below the current price. When one of the orders is executed the other order is canceled. Example: The price of EUR/USD is 1.2040. You want to either buy at 1.2095 over the resistance level in anticipation of a breakout or initiate a selling position if the price falls below 1.1985. The understanding is that if 1.2095 is reached, you will buy order will be triggered and the 1.1985 sell order will be automatically canceled.

Always check with your broker for specific order information and to see if any rollover fees will be applied if a position is held longer than one day. Keeping your ordering rules simple is the best strategy.

### **Summary**

The basic order types (market, stop loss, and limit) are usually all that most traders ever need. Unless you are a veteran trader, don't get fancy and design a trading system requiring a large number of orders sandwiched in the market at all times – stick with the basic stuff first.

Make sure you fully understand and are comfortable with your broker's order entry system before executing a trade.

**DO NOT** make a trade with real money *until* you have an extremely high comfort level with the trading platform and order entry system.

## Forex versus Stocks/Futures

Forex versus Stocks Advantages		
Advantage	Forex	Stocks/Futures
24-hour Trading	YES	NO
Commission Free Trading	YES	NO
Instant Execution of Market Orders	YES	NO
Short-Selling without an Uptick	YES	NO

### 24-Hour Market

As we mentioned, the Forex market is a seamless 24-hour market for 5 ½ days of the week.

### Commission Free Trading

Forex brokers charge no commission or additional transactions fees to trade currencies online or over the phone. Combined with the tight, consistent, and fully transparent spread, Forex trading costs are lower than those of any other market. The brokers are compensated for their services through the bid/ask prices.

### Instantaneous Execution of Market Orders

Your trades are instantly executed under normal market conditions. You also have price certainty on every market order under normal market conditions. What you click is the price you get. You're able to execute directly off real-time streaming prices. There's no discrepancy between the displayed price shown on the platform and the execution price to enter your trade. Keep in mind that most brokers only guarantee stop, limit, and entry orders are only guaranteed under normal market conditions. Fills are instantaneous most of the time, but under extraordinarily volatile market conditions order execution may experience delays.

### Short-Selling without an Uptick

Unlike the (US) equity market, there is no restriction on short selling in the currency market. Trading opportunities exist in the currency market regardless of whether a trader is long or short, or which way the market is moving. Since currency trading always involves buying one currency and selling another, there is no structural bias to the market. So you always have equal access to trade in a rising or falling market.

## Other Forex Attributes

### **No Middlemen**

Centralized exchanges provide many advantages to the trader. However, one of the problems with any centralized exchange is the involvement of middlemen. Any party located in between the trader and the buyer or seller of the security or instrument traded will cost them money. The cost can be either in time or in fees. Spot currency trading does away with the middlemen and allows clients to interact directly with the market-maker responsible for the pricing on a particular currency pair. Forex traders get quicker access and cheaper costs.

### **Buy/Sell programs do not control the market**

How many times have you heard that "fund A" was selling "X" or buying "Z"? Rumor had it that the funds were taking profits because of the end of the financial year or because today is "triple witching day", all as an explanation of why this stock is up or the market in general is down or positive on the session. The stock market is very susceptible to large fund buying and selling.

In spot trading, the size and liquidity of the Forex market makes the likelihood of any one fund or bank to control a particular currency very slim. Banks, hedge funds, governments, retail currency conversion houses and large net-worth individuals are just some of the participants in the spot currency markets where the liquidity is unprecedented.

### **Analysts and brokerage firms are less likely to influence the market**

Have you watched TV lately? Heard about a certain Internet stock and an analyst of a prestigious brokerage firm accused of keeping its recommendations, such as "buy" when the stock was rapidly declining? It is the nature of these relationships. No matter what the government does to step in and discourage this type of activity, we have not heard the last of it.

IPO's are big business for both the companies going public and the brokerage houses. Relationships are mutually beneficial and analysts work for the brokerage houses that need the companies as clients. That catch-22 will never disappear.

Foreign exchange, as the prime market, generates billions in revenue for the world's banks and is a necessity of the global markets. Analysts in foreign exchange don't drive the deal flow, they just analyze the forex market.

### **8,000 stocks versus 4 major currency pairs**

There are approximately 4,500 stocks listed on the New York Stock exchange. Another 3,500 are listed on the NASDAQ. Which one will you trade? Got the time to stay on top of so many companies? In spot currency trading, there are dozens of currencies traded, but the majority of the market trades the 4 major pairs.

## Liquidity

In the spot Forex market, around \$3 trillion is traded daily, making it the largest and most liquid market in the world. This market can absorb trading volume and transaction sizes that dwarf the capacity of any other market. The futures market trades a puny \$30 billion per day. The FX market trades more than 35 times the combined volume of all global stock exchanges each and every day. No other market can compete with its limited liquidity. The Forex market is always liquid, meaning positions can be liquidated and stop orders executed without slippage except in extremely volatile market conditions.

# Forex Terminology

As in any new skill that you learn, you need to learn the lingo. Here's the most common terms you'll hear...

## Major and Minor Currencies

The eight most frequently traded currencies (USD, EUR, JPY, GBP, CHF, CAD, NZD and AUD) are called the **major currencies**. All other currencies are referred to as **minor currencies**. Do not worry about the minor currencies, you don't need to trade them, and the spreads are much higher. Stick with the top 5 or 6 majors (USD, EUR, JPY, GBP, AUD and CHF). These pairs are the most liquid and cheapest to trade.

## Base Currency

The **base currency** is the first currency in any currency pair. It shows how much the base currency is worth as measured against the **second currency**. For example, if the USD/CHF rate equals 1.6350, then one USD is worth CHF 1.6350. In the Forex 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 and New Zealand dollar.

## Quote Currency

The **quote currency** is the second currency in any currency pair. This is frequently called the **pip currency** and any unrealized profit or loss is expressed in this currency.

## Pip

A **pip** is the smallest unit of price for any currency. Nearly all currency pairs consist of five significant digits and most pairs have the decimal point immediately after the first digit, that is,

EUR/USD equals 1.2538. In this instance, a single pip equals the smallest change in the fourth decimal place - that is, 0.0001. Therefore, if the quote currency in any pair is USD, then one pip always equal 1/100 of a cent.

One notable exception is the USD/JPY pair where a pip equals \$0.01.

### **Bid Price**

The **bid** is the price at which the market is prepared to buy a specific currency pair in the Forex market. At this price, the trader can sell the base currency. It is shown on the left side of the quotation.

For example, in the quote GBP/USD 1.8812/15, the **bid price** is 1.8812. This means you sell one British pound for 1.8812 US dollars.

### **Ask Price**

The **ask** is the price at which the market is prepared to sell a specific currency pair in the Forex market. At this price, you can buy the base currency. It is shown on the right side of the quotation.

For example, in the quote EUR/USD 1.2812/15, the **ask price** is 1.2815. This means you can buy one Euro for 1.2815 US dollars. The ask price is also called the **offer price**.

### **Bid/Ask Spread**

The **spread** is the difference between the bid and ask price. The "**big figure quote**" is the dealer expression referring to the first few digits of an exchange rate. These digits are often omitted in dealer quotes. For example, the USD/JPY rate might be 118.30/118.34, but would be quoted verbally without the first three digits as "30/34".

### **Quote Convention**

Exchange rates in the Forex market are expressed using the following format:

Base currency / Quote currency      Bid / Ask

### **Transaction Cost**

The critical characteristic of the bid/ask spread is that it is also the **transaction cost** for a round-turn trade. Round-turn means both a buy (or sell) trade and an offsetting sell (or buy) trade of the same size in the same currency pair. For example, in the case of the EUR/USD rate of 1.2812/15, the transaction cost is three pips.

The formula for calculating the transaction cost is:

$$\text{Transaction cost} = \text{Ask Price} - \text{Bid Price}$$

### **Cross Currency**

A cross currency is any pair in which neither currency is the US dollar. These pairs exhibit erratic price behavior since the trader has, in effect, initiated two USD trades. For example, initiating a long (buy) EUR/GBP is equivalent to buying a EUR/USD currency pair and selling a GBP/USD. Cross currency pairs frequently carry a higher transaction cost.

### **Margin**

When you open a new margin account with a Forex broker, you must deposit a minimum amount with that broker. This minimum varies from broker to broker and can be as low as \$100 to as high as \$100,000.

Each time you execute a new trade, a certain percentage of the account balance in the margin account will be set aside as the **initial margin requirement** for the new trade based upon the underlying currency pair, its current price, and the number of units (or lots) traded. The lot size always refers to the base currency.

For example, let's say you open a mini account which provides a 200:1 leverage or 0.5% margin. Mini accounts trade mini lots. Let's say one mini lot equals \$10,000. If you were to open one mini-lot, instead of having to provide the full \$10,000, you would only need \$50 ( $\$10,000 \times 0.5\% = \$50$ ).

### **Leverage**

**Leverage** is the ratio of the amount capital used in a transaction to the required security deposit (margin). It is the ability to control large dollar amounts of a security with a relatively small amount of capital. Leveraging varies dramatically with different brokers, ranging from 2:1 to 700:1.

### **Margin + Leverage = Possible Deadly Combination**

Trading currencies on margin lets you increase your buying power. Meaning that if you have \$5,000 cash in a margin account that allows 100:1 leverage, you could purchase up to \$500,000 worth of currency because you only have to post one percent of the purchase price as collateral. Another way of saying this is that you have \$500,000 in buying power.

With more buying power, you can increase your total return on investment with less cash outlay. But be careful, trading on margin magnifies your profits AND losses.

### **Margin Call**

All traders fear the dreaded margin call. This occurs when your broker notifies you that your margin deposits have fallen below the required minimum level because an open position has moved against you.

While trading on margin can be a profitable investment strategy, it is important that you take the time to understand the risks. Make sure you fully understand how your margin account works, and be sure to read the margin agreement between you and your broker. Always ask any questions if there is anything unclear to you in the agreement.

Your positions could be partially or totally liquidated should the available margin in your account fall below a predetermined threshold. You may not receive a margin call before your positions are liquidated (the ultimate unexpected birthday gift).

Margin calls can be effectively avoided by monitoring your account balance on a very regular basis and by utilizing strict capital management procedures. These are difficult to understand and/or implement in the heat of battle, and that is why account 'blow-ups' are all too common among amateur FX traders. Don't fall into that trap!

If you are interested in having the United Mutual algorithm applied to your account, please [contact us](#).