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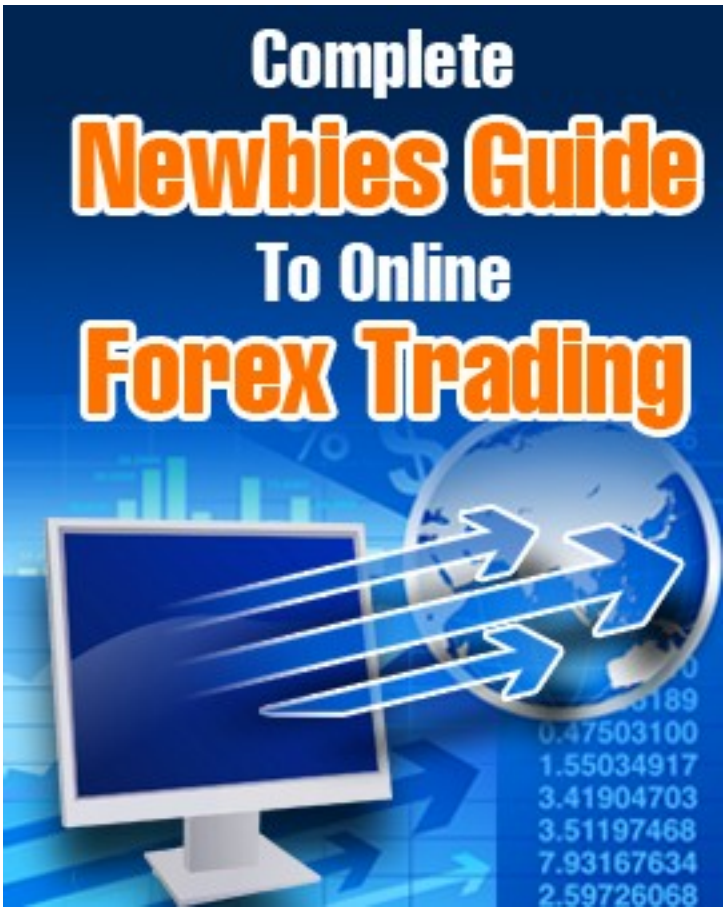

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The Complete Newbies Guide To Online Forex Trading

Welcome

Thank you for downloading **The Complete Newbies Guide To Online Forex Trading!** I hope you will find real value in this report.

If you are new to Forex trading, but not to stock investing, then this guide should help you to get a feel for the differences between trading on the foreign exchange market versus trading on the traditional Stock market.

If you are new to investing in general, then this guide can open your eyes to a world you never knew existed, while not overwhelming you with too much complicated financial jargon.

There are a lot factors unique to the Forex market which make it a very exciting, fast-paced alternative to traditional investing:

- The market runs 24 hours a day from late Sunday to late Friday.
- The market is affected by world events and news more so than others
- There are no commissions to be paid out on your trades
- Extremely high-liquidity
- 100:1 Leverage (move $100,000 in currency using only $1,000 of your own money!)

These factors alone make Forex a fun and intellectually stimulating challenge. If you love to watch the news, keep up with politics and piece together all of the ways that the 'powers that be' influence the global economy, then you will *really* love the foreign exchange market.

In order to be a good trader, you must learn to see how events in one part of the world create ripples that affect the economies of nations all the way on the other side. It is truly a study in the interrelatedness of us all.

My hope is that you will be truly excited about Forex after reading this report, and come away with enough knowledge and confidence to pursue additional education on the subject if you so choose.

Introduction

What Is The Forex Market All About?

The term **'Forex'** is short-hand for '**foreign exchange**.' The Forex Market = The Foreign Exchange Market.

What is being exchanged on this market is *not* stocks or bonds, but **currencies** (monies) from around the world.

In other words, the Forex market is *the* place where U.S. dollars, Euros, Yen and other major currencies are bought and sold. It represents the largest financial market in the world by volume.

The origins of the foreign exchange market date back to 1944, when The United Nations Monetary Fund convened in Bretton Woods, New Hampshire to devise a plan for stabilizing the world economy.

The British Pound had been, up until World War II, the monetary unit of choice when comparing the relative value of foreign currencies. However, Hitler's regime managed to devalue the Pound by way of a massive counterfeiting scheme. Something had to be done quickly in order to avert a worldwide economic depression.

Out of this meeting came the **Bretton Woods Accord.** This new policy implemented the Gold Standard, tying the value the U.S. Dollar to the price of one ounce of gold ($35.00 per ounce at the time). It was further agreed that the Dollar would replace the British Pound as the benchmark “currency of exchange”.

All other currencies were aligned to the Dollar, and a 'fixed exchange rate” of +/- 1% was established.

In other words, a foreign currency could fluctuate a maximum of 1% higher or lower than the Dollar. Any fluctuations beyond this limit required that the 'offending' nation's central bank step in to correct the imbalance.

The Bretton Woods accord remained in effect until 1971, when it was determined that the U.S. dollar could no longer hold steady relative to gold. At this time, the 'fixed exchange rate' model was abandoned in favor of the 'floating exchange rate' we still use today.

Note: If any of these terms are unclear or confusing, don't worry. We'll look at them more closely when we get into the nuts and bolts of Forex.

The important thing to understand right now is that Forex trading among private investors is still relatively new. The market once operated almost exclusively between government (central) banks and commercial banks until advances in communication, such as the Internet and PC banking, allowed speculators easier access to the market.

The Forex Market today represents the largest and most 'liquid' of all markets in the world. The daily 'turnover' of trade volume, speaking in U.S. dollar terms, is on the order of *trillions.*

The major players involved in these trades are:

- ✓ Banks
- ✓ Governments
- ✓ Speculators
- ✓ Corporations
- ✓ Other, related financial markets and institutions (e.g., brokers)

Now, one of the first things you must understand is that these institutions are NOT all on a level playing field with one another.

Unlike the stock markets, the Forex market is divided into restricted levels of access.

In other words, not all Forex traders have equal access to the same prices. The bid price and asking price (also known as the “spread”) between currencies is in part determined by the *size and volume* of the trade*.*

The more money a trading entity can put on the line, the better the 'spread'.

As you might surmise, the central and world banking institutions (the 'inter-bank' market) are at the top of the tier. They are followed next by governments and large financial institutions or corporations.

A Typical 'Top 10' List of Currency Traders By Volume:

Deutsche Bank - 19.30%

UBS AG - 14.85%

Citi - 9.00%

Royal Bank of Scotland - 8.90%

Barclays Capital - 8.80%

Bank of America - 5.29%

HSBC - 4.36%

Goldman Sachs - 4.`14%

JPMorgan - 3.33 %

Morgan Stanley - 2.86%

These are the '800 pound gorillas' of the foreign exchange market. They turn serious profits even on the most razor-thin of margins due to the amount of currency they can move on even one trade.

How Do Individual Traders Fit In On The Forex Market?

The short answer to this question is: they *don't*. Not on their own. Individual traders like you and I are known as “Retail Traders”, and must go through **retail brokerage firms** in order to buy and sell currencies on the foreign exchange market.

You should know up front that online retail trading by individuals (represented by online retail brokers) is still in its infancy. Prior to the Internet, and subsequent availability of real-time market data, it was virtually impossible for the average person to get involved in the foreign exchange market with any degree of success.

Today, however, you can buy and sell currencies at the click of a button, in much the same way as you buy and sell stocks. Everything has been automated and linked up electronically.

In the interest of full disclosure, you should also know that Forex trading is not as straight-forward as trading stocks on the stock exchange. There are many, many variables to take into consideration when it comes to determining fluctuations in currency values. There is a lot of 'jargon' to learn, and a fair share of complex concepts which must be mastered.

Unfortunately, there are unscrupulous companies out there who take advantage of this 'learning curve', and attempt to scam would-be retail traders. Forex opportunity scams are still prevalent - some estimates place the number as high as 90% .

Therefore, it is imperative that you learn the basics of Forex before you get involved with any 'advanced' training courses, trading systems or online brokers!

While a full crash course on Forex is beyond the scope of this report, you *will* learn the basics here. I can't make you an expert, but I can give you the knowledge you need to make an informed decision about whether to get involved - and whether the retail broker you're dealing with is on the up and up.

What Will 'The Complete Newbies Guide To Online Forex Trading' Teach Me?

This guide will teach you the absolute basics of Forex. You'll learn the fundamental concepts and terms involved in an average trade, as well as...

- ✓ How currency values are determined
- ✓ How and why currency values are relative
- ✓ Why currency is traded in 'pairs', and what that means

- ✓ The difference between the 'bid price' and the 'ask price' of a currency
- ✓ The relationship between 'Pips', 'Lot Sizes' and 'Spreads', and what each of those mean.
- ✓ What your broker means by 'leverage', 'usable margin' and 'margin calls'
- ✓ Factors affecting currency valuations
- ✓ Where to get more information

What Will 'The Complete Newbies Guide To Online Forex Trading' NOT Teach Me?

Forex trading is such a complex topic that it would be impossible to cover all aspects of it in a short report. Even some of the basics are too complex to dive into completely here.

So, you should be aware of the limitations of this guide:

1) We will not cover the trade of precious metals, futures or derivatives.
2) We will not cover the use of technical tools or 'charting' programs used in spotting patterns.
3) Advanced vocabulary and concepts are not covered
4) This is not a 'how to get rich quick' report!

Again, my goal here is to give you the 'big picture' so that you can get a feel for what Forex is all about, and decide whether investing on this market makes sense as a part of your long-term financial strategy.

Where Can I Find More Information?

There is a wealth of great, free information online at sites such as:

http://www.fxstreet.com/

http://www.investorpedia.com/

http://www.forextrading.com/

However, I also recommend investing in at least one training course. There are a number of

excellent courses available online that will take you by the hand, and guide you step-by-step through your first trade.

My Top Pick

Forex 101: Basic Concepts and Terms

We have quite a lot to cover here, and I want to make sure the information is presented in a way that helps you absorb it quickly, while still getting a solid, 'big picture' view of how Forex works for individual retail traders.

Therefore, I'm going to use a 'building-block' approach - starting from the simplest example of currency exchange that most people are familiar with - then moving one step at a time to paint a picture of a single retail trade.

So, let's begin with the transaction most people are familiar with - that of **exchanging one currency for another when traveling overseas**.

Imagine that you're going on a trip to France. You have $1,000 U.S. dollars to spend on food, transportation, souvenirs and tours. You're a smart traveler, though, so you don't want to carry all of that $1,000 as cash in either currency.

Instead, you put $500 into traveler's checks for safe keeping, and convert the remaining $500 into Euros (the Franc was replaced by the Euro at the formation of the European Union, of which France is a member).

On the actual day that you go to get your money converted, the **foreign exchange rate** is set at **1 US Dollar = 0.68679 Euro**. This rate is the **official, interbank rate** for strict cash-to-cash conversions.

After you do the math, you see that your $500 in U.S. Dollars turns into a mere $343.397 Euro. Ouch! You've just taken a hit to the tune of $156.60 right off the bat in term of buying power, even though you haven't spent a cent.

What happened?

What's happened is that the Euro was stronger than the Dollar at the time you made the exchange. Your Dollar wasn't worth as much as the Euro. Therefore, you could not purchase 500 Euro with 500 Dollars.

Keep in mind, however, that this wouldn't necessarily limit your buying power. How much you have to spend while in France depends on the cost of living. For example, if the equivalent of a $15 meal in the U.S. is only $12 in France, you may save enough to offset the hit you took on the exchange rate.

Now, remember that you're a smart traveler. You keep up with the financial markets, and check the exchange rate each day of your trip. On the third day, you notice that the Dollar is continuing to weaken against the Euro.

You decide to go ahead and cash out your traveler's checks before things get any worse, at a rate of **1 US Dollar = 0.67679 Euro**. This gives you $338.395 additional Euro.

By the time your trip ends, you've spent most of the $343.39 you came with, but still have the $333.39 you converted from traveler's checks. Let's say you've got an even 400 Euro with you on the trip home, just to make things easy.

You put the money away when you get home, and keep watching the market. A few weeks go by.

Suddenly, the news reports that a major mid-east oil deal has rallied and strengthened the Dollar, bringing the exchange rate to: **1 US Dollar = 0.72679 Euro**. Bingo! It's time to dig those 400 Euro out of the sock drawer, and go buy back your Dollars.

After the exchange is done, you have $550.36. Don't forget - you started off with $1,000 and lost $156.60 of it right off the bat, leaving you with the equivalent of $843.40. You spent $449.64 of that on your trip, so you should technically only have 393.76 left.

You don't, though. You have $550.36 because the Euros you came home with *bought back more dollars* than you originally held.

This represents the simplest profit on an exchange of currencies, as well as the most

elemental idea behind the Forex concept: **buy low and sell high**.

Now, while this example is representative, it is not entirely *accurate*. Real trades on the Forex market are often *much* more complex than this for anyone who wants to turn a serious profit.

Gains are made by trading far larger amounts of money, on far slimmer margins - and by exchanging multiple currencies at a time.

Concept #1 Exchange Rates

As you saw from the example above, the **exchange rate** can be defined as the the price of one currency in relation to another.

A **fixed exchange rate**, like the one established in 1944 by the Bretton Woods Accord, is an official rate set by monetary authorities (and sometimes governments).

Fixed rates are typically set to a pre-determined value (e.g., the price of an ounce of gold), and allowed only slight fluctuation.

A **floating exchange rate** is what is in effect on the foreign exchange market today. This type of rate is not set to any outside reference point.

Rather, the rate is determined by the market forces of supply and demand.

Although our earlier example used just two currencies, the Dollar and the Euro, it is important to note that ***you must NOT view Forex trades as a simple one-to-one transaction***.

Not if you want to make any real money, that is. Forex trading is not as easy as buying $10,000 worth of U.S. Dollars with $5, 000 worth of Euros after a market correction.

This doesn't mean you can't achieve these kinds gains, but you must understand that the majority of successful trades on the retail level involve a well-planned *strategy* based around buying and selling **multiple currencies** at a time - not just one or two.

This brings us to our next concept: **Currency Pairs**

Concept #2: Currency Pairs

When you buy stocks on the Stock Exchange, you have the option of buying the stock of a single company at a time, or multiple companies at a time. You may also choose to sell your stock back right away, or hold it for an indefinite period of time.

The value of stock from a company like Microsoft, for example, is determined largely by that company's *performance* (profits, meeting quarterly goals, etc), and *not directly affected* by the performance of other corporations.

The foreign exchange market works a little bit differently.

The value of any currency on Forex is determined *in relation to the value of all other currencies*. In other words, the value of 1 U.S. dollar *changes* based on whether you are comparing it to the Euro, the Australian dollar, the Japanese Yen and so on.

The buying and selling of any of these currencies is always done in what's known as **currency pairs**.

A currency pair consists of a **base currency** and a **quote currency**. The base currency is the currency you intended to purchase. The quote currency is the currency you intend to use to purchase the base currency.

Together, the pair shows you how much of the quote currency is needed to buy one 'unit' of the base currency.

To illustrate this, let's look at some exchange rates for **December. 15th, 2007**. We'll compare the U.S. Dollar against the Euro, Canadian Dollar and Japanese Yen:

1 EUR = 1.44245 USD /**1 USD** = 0.693265 EUR

1 CAD = 0.9830391 USD / **1 USD** = 1.01720 CAD

1 JPY = 0.00882807 USD / **1 USD** = 113.275 JPY

The pairs are as follows:

EUR/USD = 1.4 - selling Euros to buy Dollars
USD/EUR = 0.69 - selling Dollars to buy Euros

CAD/USD = 0.98 - selling Canada Dollars to buy U.S. Dollars
USD/CAD = 1.01 - selling U.S. Dollars to buy Canada Dollars

JPY/USD = 0.0088 - selling Yen to buy Dollars
USD/JPY = 113.27 - selling Dollars to buy Yen

Notice that the **currency being sold is listed first**. The **EUR/USD** pair tells you that for every Euro you sell, you are purchasing 1.4 U.S. Dollars. Likewise, the **USD/EUR** pair tells you that for every Dollar you sell, you are purchasing 0.69 Euro.

You are always buying and selling *simultaneously* when you trade currency on Forex.

Now, let's say that you wanted to turn a profit in **U.S. Dollars** by trading in these currencies? In an ideal scenario, you would *already be holding* **Euros** in your online trading account, and you would have purchased these Euros *on a day when the dollar was stronger.*

For example, let's say you bought 1,000 Euro when the exchange rate was USD/EUR = 1.40.

This means that every $1 you spent purchased 1.4 Euros. In order to buy 1,000 Euros at that rate, you had to spend 1000 X 1.40 = $1,400 U.S. Dollars.

Make sense?

Now, let's say you held onto those Euros until the exchange rate went up to USD/EUR = 1.44. You wouldn't want to buy the EUR/USD pair (selling your Euros to buy Dollars) because you would *lose money,* right?

Instead, you look for something like the Japanese Yen, which is valued *far below* the Dollar, and then you think: "If the Euro is worth more than $1, then I can buy more Yen with Euros than I can with Dollars. Then, I can take advantage of the Dollar's strength against the Yen."

So, you buy the Yen with the Euro and then sell the Yen back to buy Dollars.

Let's do the math:

EUR/JPY = 163.3

1,000 EUR X 163.3 = 163,300 JPY

JPY/USD = .0088

163,300 JPY X .0088 = $1,437.04 USD

$1,437.45 - $1,400 = **$37.45 Total Profit**

I want you to be able to follow this, so let's recap what happened...

First, you traded the EUR/USD pair at a time when $1,400 U.S. Dollars could buy you 1,000 Euro. You held it and waited for **both** the Dollar *and t*he Euro to *rise* against the Yen.

Then, you traded the EUR/JPY pair, effectively buying more Yen with Euros than you could with Dollars.

Finally, you traded the JPY/USD pair, and gained enough margin (via the purchasing power of the Euro) to gain a $37.45 increase on your original investment of $1,400 USD.

You effectively **leveraged** a series of currency pairs in order to profit. This is what I meant when I told you that Forex trading is never as simple as a one-to-one transaction!

There's one thing slightly off with the example I gave you above, though. You'll notice that I shortened the quotes by a few decimals places? I did so for the sake of making the math easier to follow.

However, when trading any currency pair, you ***must*** remain mindful of the full exchange

rate, all the way down to the last decimal.

Remember when I said that most profits on Forex are made by trading on *volume*, and at very slim margins?

Even the slightest change in one of those numbers can have an impact.

This brings us to our next fundamental concept: The 'Pip'.

Concept #3: 'Pips'

What the heck is a 'pip'? A pip, in Forex terms, is defined as the **smallest price change** an exchange rate can make. Most of the currency pairs you trade will be quoted out to **four decimal places**, and a shift in *any* of those decimals reflects a shift in price.

A 'standard' pip is equivalent to 1 Basis Point or 1/100th of 1%.

Again, however, most currencies (with the exception of the Yen) are quoted to four places, which means that shifts can occur in the **thousandth** and **ten-thousandths** place.

Therefore, for most major currencies:

1 Basis Point = 1/10000th of 1% = 1 Pip

While the Japanese Yen, which is only quoted to the hundredths place, follow the traditional definition of:

1 Basis Point = 1/100th of 1% = 1 Pip

This is not cut and dry, though. The **actual value** of a pip can be **fixed** or **variable**, depending on:

1) The currency pair being traded
2) The base currency used in your trading account.
3) The **lot size** of your trade.

Now we have a new term to define before we proceed: What is 'lot size'?

Lot Size refers to the size of your transaction or 'contract'. Again, trading on Forex is all about volume. Almost no one trades unit for unit, or 'dollar for dollar', although some brokers do allow this.

The typical lot size for most trades, though, is in multiples of ten:

- ✓ A Standard Lot = 100,000 units of the base currency
- ✓ A 'Mini' Lot = 10,000 units of the base currency
- ✓ A 'Micro' Lot = 1,000 units of the base currency

Calculating Pip Values

This is one area where new investors can become very confused. This is because pip values are dependent on multiple variables.

The standard definition says that a pip is equal to a change of 1/100th in the value of a currency, but this change **is not** measured solely against the previous value of the currency!

Instead, one must take into account whether the currency pair in question has a fixed value or a variable value *relative to the lot size*. Further, one must take into account **how many decimal places** are quoted for the pair.

As you saw earlier, the EUR/USD pair is typically quoted to 4 decimal places, such that if the exchange rate were to shift from '1.4436' to '1.4437', you can say that is has gained a full basis point, or 1 pip.

Contrast this with the USD/JPY pair, which is only quoted to 2 decimal places. In this case, a move from 113.27 to 113.26 represents 1 pip at a value of .**01**.

Before you get too confused...

You should know that there is **only one reliable source** for quotes: **Your Broker** . The examples used in this report so far are just that: *examples.*

I've shown you EUR/USD pairs with more than 4 decimals places in the quote - and I've shown you a USD/JPY pair with more than 2 decimals in the quote.

Do not let this confuse you.

The fact is that you can get quotes online from a variety of public sources, but these quotes **do not reflect the true buy/sell rates**.

Instead, they represent what is known as '**mid-market rates**'.

Mid-market rates are calculated by finding the **average** between buy and sell rates on high-volume transactions throughout the entire market. Further, every broker has its own set of fees or overhead charges per transaction, and these fees are *included i*n the quotes they provide.

So, when you look at the mid-market rate, what you're looking at is an average, not an exact quote. This is why the number of decimal points appears to vary.

Once you have your own account with a reputable broker, though, you'll receive accurate quotes which follow the 'rules' regarding how many decimal points out a quote should go on a given currency pair.

A Typical Pip Value Calculation

The EUR/USD pair has a **fixed value** of U.S. $10 for Standard Lots, or 100,000 units of base currency. Similarly, a 'Mini' Lot transaction of EUR/USD has a fixed value of U.S. $1.

In order to calculate the actual pip value of the base currency within the pair, you must divide 1 pip by the current exchange rate, then multiply the result by lot size:

EUR/USD = 0.0001 (1 pip) / 1.30000 (exchange rate) =
EUR 0.0000769 x 100,000 (standard lot) = EUR 7.69

Next, we want to get our result into the base currency of our account. If your account uses U.S. Dollars for the base currency, you would multiply again by the exchange rate:

7.69 x 1.30000 = $10.00 pip value

What Do Pip Values Tell Me?

Pips are used by Forex traders to **calculate profit and loss**. Recall, again, that pips represent the smallest increment changes in price of one currency relative to another.

In our EUR/USD example, a change in value of 1 pip means a potential profit or loss of U.S. $10. Whether you earn $10 or lose $10 depends on the value of the Euro relative to the Dollar (or vice versus).

Right now, the Euro is stronger - so, any downward change in the Euro would actually create a *profit* for you in U.S. Dollars. You would profit from 'buying high' and 'selling low', as counterintuitive as that sounds.

The reason Forex traders use pips to calculate profit and loss is because it simplifies the trade - or, I should say - because *standard lot sizes* simplify trades.

Pips calculations reflect the fact that almost all Forex transactions are undertaken in some multiple of 10.

We trade in lot sizes of 100,000, 10, 000 and 1,000 so that the effects of even the slightest change in currency values can be seen right away, and capitalized on immediately.

The good news that you don't have to calculate these values yourself. Your broker will do it for you, and the information will be available in your online account.

It is crucial that you understand pips values on the conceptual level, even if you don't want to do the math yourself.

Concept #4 - Anatomy of a Trade: Bid Price, Ask Price and 'Spread'

Forex quotes include more than just the exchange rate. They also include a **bid price** and an **ask price**. Where do these prices come from?

They come from entities known as **forex market makers**. These market makers consist of banks and brokerages that are ready to buy and sell currency at a moment's notice.

If these market makers didn't exist, you would not be able to buy or sell currency at will. There has to be someone else involved in the transaction.

It is the market maker who sets the **ask price** for the currency being sold. The ask price is always higher than the **bid price**, which is typically equivalent to the **exchange rate**.

So, let's say that you want to buy Canadian Dollars. The market maker must purchase your U.S. Dollars with Canadian Dollars, so the transaction will first be expressed in terms of the exchange rate for the currency pair:

CAD/USD = 1.2

It will cost the market maker $1.20 CAD to purchase $1.00 USD from you. Good so far, right? Now, let's say you intend to sell $100 USD.

The **bid price**, then, is $120 CAD for $100 USD.

However, the market maker can choose to quote a higher price for his base currency. He can, for example, quote you an **ask price** of $100.05 USD for $120 CAD.

On your end of the transaction, though, you will see this mark-up expressed in CAD as an ask price of $120.05. In doing so, the market maker profits by requiring you to buy a fraction more Canadian Dollars, so that he receives a fraction more in U.S. Dollars.

120.05 - 100.00 = 0.05 or $0.0005

This number represents what's known as the **spread**.

The concept of the “spread” is important when determining your profit and loss because you may be subject to it both when entering and exiting a trade. The amount of the spread will vary based on whether you are the **buyer** or the **seller**.

In the CAD/USD example, you entered the trade as a **buyer**. The fact that you are technically 'selling' U.S. Dollars in exchange for the Canadian Dollars does not matter here because the trade began with you responding *as a buyer* to a market maker's **ask price**.

If you wanted to enter a trade as a **seller**, then you would need to respond to a **bid price** for currency that you already hold.

The general rule of thumb is this:

- ✓ As a buyer, you pay the spread as you enter a trade, but not when you exit.
- ✓ As a seller, you do not pay the spread as you enter a trade, but you do pay it

when you exit as buyer.

At this point, you might be thinking to yourself: “It looks like I get hit with a spread no matter what I do, because I'll inevitably be in the role 'buyer' at some point on every trade.” This is true, but your profit and loss depends partly on what kind of spread you're subject to during the transaction.

In our CAD/USD example, where you are a buyer, you are subject to the following spread on a trade of 100,000 units:

(.0001/1.2) x 100,000 = $8.33 x 5 pips = $41.65

If you close the trade as a seller at CAD/USD = 1.25 (bid price)/1.27 (ask price), you are not subject to the new spread of $0.0007 (7 pips). You simply close the trade with a sale, and subtract the spread from your profit.

However, let's say that you already had some Canadian Dollars, and decided to enter the trade as a seller at 1.27, then close the trade as a buyer?

You would be subject to the new spread of 7 pips, or $56.

This means you have a potential gain or loss of $14.35 per lot, depending on when you enter the trade, and whether you have entered as a buyer or seller. It may not seem like much, but these types of losses and gains accrue with each trade.

As a retail trader, your margins will be small to begin with, and you can't afford to be careless.

Speaking of margins, you may wonder how you can get involved with Forex when the average lot size is $100,000?

Concept #5: Margins and Leverage

Every broker will have a minimum deposit you must meet in order to open an account, as well as minimum account levels required to trade a specific lot size.

The minimums are known as **initial margins** or **usable margins**. Some brokers might allow you to open an account at lowest 'usable margin' possible, while others may require more as assurance against you falling below the minimum too rapidly.

The good news is that retail brokers typically do not require matching deposits. In other words, you need not deposit $100,000 in order to trade $100,000.

Instead, your broker will usually 'front' you the money on good faith. For instance, if you're broker requires you to trade in lot sizes of $100,000, you may be able to open an account for $1,000.

It is somewhat like getting a loan you don't have to repay because you get to “play” with

$100,000 that isn't really in your account.

So, let's say you do really well and manage to trade your way from $100,000 to $105, 000:

$$\$105,000 - \$100,000 = \$5,000$$

You've now raised your ***real*** account balance to $6,000, and your **usable margin** by a factor of six. Remember, if your broker is matching you $100,000 for every $1,000 in your account, then your $6,000 account balance gives you $600,000 worth of **leverage** for trading on the market.

What happens if you fall below margin?

Let's say that your account balance falls below $1,000. Your broker can no longer match you with $100,000, and this means you have **no** usable margin, as the minimum to hold one open position on the market IS $100,000.

Neither you nor your broker will benefit from your account balance going negative, but it will do so if you don't have enough usable margin to hold your position.

Should you fall below margin, there are only 2 options:

1) You deposit more money into your account, or..

2) Your broker is forced to issue a **margin call.**

When your broker issues a margin call, he will close all of your open positions - in other words - he will cancel pending 'buys' and complete pending 'sales' to minimize loss, and insure that you do not lose your opening deposit.

Policies on margin calls vary from broker to broker, and you should familiarize yourself with your broker's policies prior to opening an account.

Some brokers will describe their policies in terms of **leverage ratio,** while others prefer to use **margin percentage.**

These requirements can be expressed mathematically as:

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

Also, keep in mind that Forex trades for only 5 days out of the week. If you open a new position on Friday and hold it over the weekend, you may subject to a higher margin percent than you would be during the work week.

The best approach is to know your broker's policies inside and out before you get involved, and determine what level of risk *you* are comfortable with taking.

Forex 102: Factors Affecting the Global Currency Market

Many people find the 'predictions game' the most enjoyable aspect of Forex trading. In order to develop solid mid-rang and long-range trading strategies, you have to acquire a fairly sophisticated knowledge of economics.

So, you ask, which factors most influence the global currency market?

There are 5 key areas you need to pay attention to in order to become a top-notch Forex investor:

- ✓ Interest Rates
- ✓ Economic Growth
- ✓ Mergers and Acquisitions
- ✓ Trade and Capital Flow
- ✓ Geo-Politics

We'll take a look at each area now, and how you can take advantage of these factors.

Interest Rates

The Forex market allows you to profit from differences between the interest rates of different countries. Interest rates on a currency from a given country are set by that country's central bank.

In general, you want to purchase low interest rate currencies first, and use these to finance your purchase of high interest currencies or other instruments. This tactic is known as generating **interest income**.

A second tactic involves generating income from **capital appreciation**. It has been observed that a rise in a country's interest rate usually triggers a corresponding rise in currency value.

The main thing to understand about **interest income** and **capital appreciation** is that any shift in interest rates presents you with an opportunity to play interest rate differentials against each other.

The corresponding rise and fall in currency values means that interest rates make for powerful and generally very reliable Forex indicators.

Economic Growth

Positive economic growth is strongly tied to a rise in currency value. Why?

When an economy is in a growth period, inflation tends to follow. What do the central banks do when the threat of inflation is looming ahead? Typically, they raise interest rates in order to slow down the economic boom just a bit.

Now, when interest rates go up, investors - especially foreign investors - start putting more money into the economy. More investors means more demand for the currency. So, the value of the currency goes up.

Likewise, a slow in growth or even a significant downturn will cause the reverse of this chain reaction to take place. Central banks tend to cut interest rates to give sluggish economies a shot in the arm.

However, lower interest rates mean lower returns for investors. They respond by pulling out of the market. This results in less demand for the currency, followed by a drop in currency value.

Mergers and Acquisitions

Mergers and acquisitions are relevant indicators, though perhaps not as strong as the others discussed here.

However, mergers and acquisitions between large, multinational companies can and do have an impact on currency values for the short-term. The reason should be fairly clear when you think about it.
In order to complete an acquisition, for example, the corporation that is attempting to purchase a corporation based in another country must enter the Forex market to purchase the corresponding currency.

During the window of time that the acquisition is pending, it is not unusual to see a spike in currency value on both sides.

Trade and Capital Flow

Countries may be said to be dependent on *either* **trade flow** or **capital flow.**

A country dependent on **trade flow** brings in the larger part of its income from by its trade or exports with other countries.

Some examples of trade flow dependent economies include:

- ✓ Canada - oil exports
- ✓ Australia - precious metals exports
- ✓ New Zealand - agricultural exports
- ✓ Japan - electronics and automotive exports

Each of these countries depend largely on their foreign exports for economic growth. Remember when Japan's economy was booming due to all the cars and electronics they were exporting across the world?

A country dependent upon **capital flow** brings in the bulk of its income by attracting outside, foreign investments. The **U.S.** and **Great Britain** are primary examples of capital flow dependent countries.

This is because the financial investment markets, on the whole, are very large and highly liquid in these countries. They draw in a steady pool of investors both from within and without, but are particularly reliant on the influx of capital from foreign investors.

Take from this another set of potential Forex signals to watch:

- ✓ Any event impacting the flow of trade
- ✓ Any event impacting the flow of capital

And keep in mind that these events may be something more than new trade agreements or faltering investor confidence. Natural disasters, for example, can have an impact on trade dependent countries that rely on agriculture for their exports.

Geo-Politics

Unlike stocks, currencies are quite sensitive to events in the political sphere. In a way, currencies are a lot like “flags” - they may represent everything good *and* bad about the country they serve.

It is not unusual for foreign investors to devalue currencies intentionally as a way of sending a message about a country's politics. It is also quite common for adversarial governments to take actions towards devaluing the currency of an 'enemy' or problem country.

One need look no further than the current controversy surrounding the United States' war effort. The Dollar has taken a beating along with the U.S. in terms of image.

Many countries are now threatening to denominate their oil exchanges in currencies other than the U.S. Dollar (which has been standard since the 1970s'), as well. If that occurs, the almighty Dollar may crash farther than it ever has at any time in history.

So, pay attention to politics as much as you can!

Any time a major political player does something to indicate a vote of confidence (or lack thereof) in his own country or another, you're sure to see a corresponding change in currency value.

Conclusion

What you have read here so far truly is the tip-of-the-iceberg concerning Forex. Although the **act** of currency trading is relatively straight-forward, the actual dynamics and logic behind currency pricing is not.

There is must you'll still need to learn before you are able to invest successfully on Forex. This includes learning how to perform complex trades (e.g. futures or swaps), how to read signal charting software, and how to create your own investment strategy.

The best thing I can recommend to you now is to proceed with patience. Keep learning as much as you can, and at your own pace. Nothing will help you more than continuing to invest in your own education.

Once you feel you've got the basics down, you can open up a demo account with most online brokers in order to test out your skills, pinpoint your weaknesses and adjust strategies as necessary.

Happy trading!

To Your Success,
Mike Saunders