

Getting Started With Forex Trading:

A Forex Primer



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Market Overview

Forex or FX, is an abbreviation for Foreign Exchange. It is a way of trading exchange rates between two different currencies. Basically, you buy one currency and sell the other for the purpose of investment speculation. The goal is to make a profit when the value or exchange rates of the currencies traded move in your favor.

Forex has more daily volume than any other market in the world. Taking place in the major financial institutions across the globe, the Forex market is open 24 hours a day.

Over 90% of all currencies are traded against the US Dollar (USD). The next most-traded currencies are the Euro (EUR), Japanese Yen (JPY), Pound Sterling (GBP) and Swiss Franc (CHF).

The Players

There are four primary groups that trade the Forex market:

First, the Novice or Retail Traders – these are part-time, non-professional traders who are speculating on market direction – not hedging, that is, not using these markets as part of other international business dealings.

Second, the Dealers – these are the market makers, setting prices and putting together trades.

The third group, the Institutional Traders, work in banks or government agencies. They trade huge amounts of money and the size of their trades moves the markets. These traders are often trading to settle accounts for import/export and other actual international business dealings.

Last, are the Advanced Traders. This group comprises professional full-time traders, people from all across the world, sitting in smaller investment firms, offices, or even their homes. Again, these traders are generally speculating on market direction – not hedging.

Interbank

The term INTERBANK discussed in FX terminology simply means ‘between banks and large institutions’ where information is exchanged about the current rate at which their clients or they could buy or sell a currency. However, the term ‘Interbank’ today also means anybody who is prepared to buy or sell a currency. Interbank also implies that Forex is not traded on an exchange like equities and futures.

The quoted prices for a Forex are based on information from the top banks and large institutions.

Benefits of Trading Forex

Lower Trading Costs

When trading Forex with TradeStation, you pay a small commission, and the bid-ask spread also adds to the cost of trading. However, there are no real-time data exchange fees, real-time Forex data is Free.

24 Hour Market Action

The Forex currency market is a seamless 24-hour market. From 5PM EST Sunday to 5PM EST Friday.

Leverage

Forex trading often allows borrowing leverage up to 100 times your account value. Remember that while leverage can help build profits quickly, it can also produce large, catastrophic losses.

High Liquidity

The Forex market, with an average trading volume of over \$1.3 trillion per day, is the most liquid market in the world. This means that a trader can usually enter or exit the market at will in almost any market condition usually without regard to trade size limitations.

Placing a Trade

Placing a trade in the Forex market is simple. The mechanics of a trade are virtually identical to those found in the markets you are trading now. A Forex trade is a trade in which one currency is valued against another.

Available Symbols to Trade at TradeStation

<u>Forex Symbol</u>	<u>Currency Pairs</u>
AUDJPY	Aust Dollar / Japanese Yen
AUDUSD	Aust Dollar / US Dollar
CADJPY	Canadian Dollar / Japanese Yen
CHFJPY	Swiss Franc / Japanese Yen
EURAUD	Euro / Australian Dollar
EURCAD	Euro / Canadian Dollar
EURCHF	Euro / Swiss Franc
EURGBP	Euro / British Pound
EURJPY	Euro / Japanese Yen
EURUSD	Euro / US Dollar
GBPCHF	British Pound / Swiss Franc
GBPJPY	British Pound / Japanese Yen
GBPUSD	British Pound / US Dollar
NZDJPY	New Zealand \$ / Japanese Yen
NZDUSD	New Zealand \$ / US Dollar
USDCAD	US Dollar / Canadian Dollar
USDCHF	US Dollar / Swiss Franc
USDJPY	US Dollar / Japanese Yen

The symbol for each Forex contract is based on the two currencies:

EURUSD = Euro Dollar vs. US Dollar.

Also, each Forex contract is a price for the first currency in the symbol name, quoted in the second currency in the symbol name. In the case of the Euro vs. US Dollar, where the exchange rate is approximately \$1.30, it would take USD 1.30 to purchase 1.00 Euro.

Each Forex contract covers a fixed number of units of the first symbol in the symbol name, usually 100,000. Forex exchange rate prices move in fixed minimum price movements called pips. A pip is the minimum price move an exchange rate can make. TradeStation offers the ability to trade in fractional pips.

Closing out a Position

An open position is one that is live and ongoing. As long as the position is open, its value will fluctuate in accordance with the exchange rate in the market. Any profits and losses will exist on paper only and will be reflected in your margin account.

To close out your position, you conduct an equal and opposite trade in the same currency pair. For example, if you have bought (“gone long”) one lot of EURUSD (at the prevailing offer price) you can close out that position by subsequently selling one EURUSD lot (at the prevailing bid price).

Understanding Bid & Ask

A Bid is what someone is willing to pay for an asset. The Ask, or offer, is what someone is willing to accept to sell an asset.

As a Forex trader, you Buy at the Ask and Sell at the Bid.

	Symbol	Bid	Ask		Symbol	Bid	Ask
1	AUDJPY	¥104.86300	¥104.90300	10	EURUSD	\$1.34633	\$1.34646
2	AUDUSD	\$0.84673	\$0.84698	11	GBPCHF	SFr.2.45603	SFr.2.45688
3	CADJPY	¥115.87900	¥115.93200	12	GBPJPY	¥247.53800	¥247.61300
4	CHFJPY	¥100.77000	¥100.80500	13	GBPUSD	\$1.99870	\$1.99905
5	EURAUD	\$1.58942	\$1.59027	14	NZDJPY	¥94.80500	¥94.86400
6	EURCAD	\$1.43835	\$1.43915	15	NZDUSD	\$0.76555	\$0.76592
7	EURCHF	SFr.1.65455	SFr.1.65475	16	USDCAD	\$1.06847	\$1.06882
8	EURGBP	£0.67341	£0.67360	17	USDCHF	SFr.1.22878	SFr.1.22907
9	EURJPY	¥166.74100	¥166.77200	18	USDJPY	¥123.84700	¥123.86800

Forex Symbols

TradeStation Forex Quotes from RadarScreen.

All Forex symbols are quoted with fractional bid & ask prices and you can trade in fractional pips as well. This allows for tighter bid & ask spreads and lower overall transactional costs.

A pip is the minimum movement for a currency pair.

You will notice that there are two exchange rates for each currency pair: the Bid, which is the rate at which you can Sell; and the Ask, which is the rate at which you can Buy. The difference is known as the spread, and determines the transactional cost of the trade. Each currency pair has its own fixed Bid-Ask spread.

Forex Symbols

Understanding the Forex symbol is essential to Forex trading. You need to remember that the first currency listed in the symbol is the base currency, and the quote is the base currency in terms of the second currency in the symbol.

Major currency pairs are EUR/USD, GBP/USD, USD/JPY, and USD/CHF.

For example:

1.) A price quote of EURUSD at 1.30851 means that one Euro is equal to 1.30851 U.S. Dollars. When that number increases, it means the Euro is appreciating while the U.S. Dollar is depreciating and vice versa.

2.) USDJPY is trading at 124.000. It means 1 U.S. Dollar is equal to 124 Japanese Yen. An increase in the number means that the U.S. Dollar is appreciating while the Japanese Yen is depreciating, and vice versa.

Again, if a currency quote goes higher, that increases the value of the base currency. A lower quote means the base currency is weakening.

Cross currency pairs are currency pairs that do not involve the U.S. dollar.

For example:

3.) With EURJPY at a price of 126.34, it means that 1 Euro is equal to 126.34 Japanese Yen.

The Costs of Trading

There is a small commission charge when you trade the Forex markets with TradeStation. However, the bid ask spreads have been tightened to reduce overall transactional costs incurred each time you make a trade.

Commission Examples:

#1: 100,000 EURUSD = \$2.67 (0.00002 X 133,333*)

#2: 100,000 GBPUSD = \$4.00 (0.00002 X 200,000**)

#3: 100,000 EURJPY = \$2.67 (0.00002 X 133,333***)

* Assuming fill price of 1.33333, ** Assuming fill price of 2.00000 ,

*** Assuming fill price of 160.000 and conversion rate = 1 USD : 120 JPY

(There is a minimum \$2.50 commission per side.

Typical Bid Ask Spreads

<u>Forex Symbol</u>	<u>Currency Pairs</u>	<u>Typical Spread</u>
EURGBP	Euro / British Pound	1 to 2 Pips
EURUSD	Euro / US Dollar	1 to 2 Pips
USDJPY	US Dollar / Japanese Yen	1 to 3 Pips
AUDUSD	Aust Dollar / US Dollar	1 to 3 Pips
EURCHF	US Dollar / Swiss Franc	1 to 3 Pips
EURJPY	Euro / Japanese Yen	2 to 4 Pips
USDCAD	US Dollar / Canadian Dollar	2 to 4 Pips
GBPUSD	British Pound / US Dollar	2 to 4 Pips
CHFJPY	Swiss Franc / Japanese Yen	2 to 4 Pips
NZDUSD	New Zealand \$ / US Dollar	2 to 4 Pips
AUDJPY	Aust Dollar / Japanese Yen	4 to 6 Pips
CADJPY	Canadian Dollar / Japanese Yen	4 to 6 Pips
NZDJPY	New Zealand \$ / Japanese Yen	4 to 6 Pips
EURCAD	Euro / Canadian Dollar	6 to 10 Pips
GBPCHF	British Pound / Swiss Franc	6 to 10 Pips
EURAUD	Euro / Australian Dollar	6 to 10 Pips
GBPJPY	British Pound / Japanese Yen	6 to 10 Pips

Pips spreads will change under different market conditions and will exceed these typical spreads at times.

Cost Example: EURUSD

Spread = Ask – Bid (1.29590 - 1.29575 = .00015)

Spread Cost = .00015 * 100,000 = \$15.00

Based on a 100,000 unit contract trade of EURUSD, the transactional bid ask cost of 1.5 pips would be \$15.00 plus a \$2.59 commission on each side.

Initial Margin

The margin for each dollar-based currency pair, where USD is the first part of the symbol, is generally \$1000.00 (100,000 units /100 to 1 margin rate. The margin required for each non-dollar based currency pair will be converted to U.S. Dollars, in real-time, at the prevailing market price for that pair. Margin rates are subject to change.

Example: EURUSD

Initial Margin = (1.2960 * 100,000) / 100 = \$1,296.00

Leverage

Leverage is the mechanism by which a trader can control a market position much larger than the initial investment. TradeStation enables you to take positions up to 100 times the value of the initial investment. However, some recommend that your open positions not exceed more than 10 times your total account value at any one time. Solely you are responsible for the risks you take and the consequences of those risks, positive or negative.

Even when market conditions are relatively calm, leverage can create both large gains or large losses very quickly. In the case where a trader surpasses the maximum leverage allowed (which can happen when account equity falls as a result of trading losses), TradeStation will close all open positions in the account. Also, TradeStation may, at any time, close open positions or implement other risk-management actions, solely at its discretion, with or without notice to you.

Rollover

For positions held open after 5 pm ET there is a daily rollover interest payment that is charged to your account if you are long the currency. If you are short the currency your account is credited the interest payment. If you do not want to earn or pay interest on your positions, make sure your positions are closed prior to 3 pm ET. Interest rate charges are set on a daily basis, and are currently approximately \$5.00 per \$100,000 contract.

Forex Math

Calculating Profit & Loss

Although the trading platform automatically does the profit and loss calculation for you in real time, it is important to understand how these equations are derived.

Profit & Loss Examples:

Based on one 100,000 unit contract trade, buying EURUSD with an initial exchange rate of \$1.3088, the initial margin is \$1,308.00.

<u>Initial Exchange Rate</u>	<u>Closing Exchange Rate</u>	<u>Gross Profit / Loss</u>
\$1.30885	\$1.32455	\$ 1,570.00
\$1.30885	\$1.29975	-\$ 910.00
\$1.30885	\$1.30855	-\$ 30.00

Equations for calculating the major currency pairs:

The equation for EUR/USD, GBP/USD, and AUD/USD (direct US currency pairs) is:
 $P/L = (\text{Closing Price} - \text{Opening Rate}) \times (\text{Lot Size}) \times (\text{Number of Lots})$

The equation for USD/JPY, USD/CHF and USD/CAD (indirect US currency pairs) is:
 $P/L = ((\text{Closing Price} - \text{Opening Rate}) / \text{Closing Price}) \times (\text{Lot Size}) \times (\text{Number of Lots})$

Note: In a 100,000 units/contract size account, 1 pip results in a \$10 profit/loss in EUR/USD, GBP/USD, AUD/USD, and approximately \$9 for USD/JPY, and \$8 for USD/CHF, based on recent prices.

Glossary

Ask - The price at which an instrument is offered.

At Best - Instructions that are given to a dealer to buy or sell at the best rate that is currently available in the market.

Base Currency - The first currency quoted in any pair.

Base Point Refers to yield on bonds. Each percentage point of yield in bonds equals 100 basis points.

Bid-Offer Spread - The difference in price between the buy (bid) and sell (offer) of a currency or financial instrument.

Carry Trade - A strategy in which an investor sells a certain currency with a relatively low interest rate and uses the funds to purchase a different currency yielding a higher interest rate. A trader using this strategy attempts to capture the difference between the rates - which can often be substantial, depending on the amount of leverage the investor chooses to use

Central Bank - A central bank provides financial and banking services for a country's government and commercial banks. It implements the government's monetary policy, as well, by changing interest rates.

Central Rate - Exchange rates against the ECU adopted for each currency within the EMS. Currencies have limited movement from the central rate according to the relevant band.

Cross-Rate - The exchange rate between two currencies.

Currency - Type of money a country uses that can be traded for other currencies on the foreign exchange market.

Day Trader - Any investor or trader who liquidates all positions prior to the close of that trading session.

Dealer - An individual or firm who purchases over the counter securities for their own account profiting or losing on them when sold. Dealers trade for their own account and risk.

European Currency Unit - A basket of the member currencies. As a composite unit, the ECU consists of all the European Community currencies, which are individually weighted

Fill or Kill - An order which must be bid or offered to the trading pit three times. If not filled by the third time, it is immediately cancelled.

Foreign Exchange - The rate for converting one currency for another.

Foreign Exchange Market - This is where currencies are traded internationally. Over a trillion dollars-worth of foreign exchange is traded globally every day, making forex larger than all bond markets put together. Foreign exchange markets exist in the form of spot, forward, futures and options markets.

Gold Standard - A national monetary system recognizing gold as a medium of exchange or measure of value.

Good Until Cancelled - A type of order that will not expire at the end of a trading session, they will continue to work until the customer instructs otherwise. These orders typically will be cancelled at the end of the month.

Gross Domestic Product - Total value of a country's output, income or expenditure produced within the country's physical borders
Gross National Product Gross domestic product plus "factor income from abroad" - income earned from investment or work abroad.

Hard Currency - Any currency that is backed by gold and that can be easily converted into another currency.

Hedging - To offset or reduce a possible loss by buying and selling other instruments that are likely to rise and fall in opposite directions under the same conditions.

IFEMA - International Foreign Exchange Master Agreement
Inconvertible Currency Any currency that cannot be exchanged for other currencies, either because this is forbidden by the foreign exchange regulations.

Indicative Quote - A market-maker's price which is not firm.

Inflation - A state of rising prices caused by intensive consumer buying and usually proportionately lesser increases in industrial output, the latter usually associated with full utilization of a country's plant and equipment.

Initial Margin - The amount of money that is required by a broker or firm in order to have the ability to buy or sell any trading instrument.

Inter-bank Rates - The bid and offer rates at which international banks place deposits with each other.

Inter-dealer Broker - A specialist broker who acts as an intermediary between market-makers who wish to buy or sell securities to improve their book positions, without revealing their identities to other market-makers.

Key currency - Small countries, which are highly dependent on exports, orientate their currencies to their major trading partners, the constituents of a currency basket.

Left-hand Side - Taking the left hand side of a two way quote or simply selling the quoted currency.

Limit Order - An order to buy or sell a specified amount of a specific instrument at a specified price or better.

Liquidation - A transaction that will offset or "close out" any open position that a customer may have.

Long - To purchase or hold any instrument.

Maintenance Margin - The minimum amount that an investor must keep on deposit in their margin account at all times in respect of each open contract.

Margin - A good faith deposit that must be in your margin account in order to place any trades.

Margin Call - A demand for additional funds to be deposited in a margin account to meet margin requirements because of adverse future price movements.

Market Maker - A market maker is a person or firm authorized to create and maintain a market in an instrument.

Market Order - An order to buy or sell a financial instrument immediately at the best possible price.

Offer - The price at which a seller is willing to sell. The best offer is the lowest such price available.

Offset - The closing-out or liquidation of a futures position.

OTC – (Over the Counter) A market conducted directly between dealers and principals via a telephone and computer network rather than a regulated exchange trading floor.

Pip - The minimum price fluctuation in the Forex (foreign exchange) market. Referred to as a tic in the futures markets.

Producer Price Index - An economic indicator which gauges the average changes on prices received by domestic producers for their output at all stages of processing.

Quote - An indicative price. The price quoted for information purposes but not to deal.

Range - The difference between the highest and lowest price of a future recorded during a given trading session.

Retail Price Index - Measurement of the monthly change in the average level of prices at retail, normally of a defined group of goods.

Right-hand Side - To do a deal on the right hand side of a two way quote, normally to buy the currency and sell dollars.

Rollover - An overnight swap, specifically the next business day against the following business day in the Forex markets (also called Tomorrow Next, abbreviated to Tom-Next).

Scalping - Buying at the bid and selling at the offer as soon as possible.

Selling rate - Rate at which a bank is willing to sell foreign currency.

Short / Short Position - To Sell or hold a sale of any financial instrument.

Soft Market - More potential sellers than buyers, which then creates an environment where rapid price falls are likely.

Spot Price/Rate - The price at which the currency is currently trading in the spot market.

Stop Loss Order - An order that is place in order to prevent a loss or limit an existing loss on any open position.

Two-Way Quotation - When a dealer quotes both buying and selling rates for foreign exchange transactions