KNOWLEDGE BASE

What is the Forex Market?

The forex market is the world's most exciting and dynamic market. With $5 trillion traded every day, it is also the largest financial market in the world.
Forex (or FX) stands for 'foreign exchange' which a traveller will know as the currency that you buy when visiting another country. For example, you may sell euros and buy dollars for your trip to the USA. The online forex market is, however, 90% speculative, which means that you don't take possession of the actual, physical currency. Rather, you open and close deals and make either a profit or loss which gets reflected in your online account.

The forex market is an over-the-counter (or OTC) market which means that trading takes place directly between two parties without dealing through an exchange. This means you can conveniently access the virtual market online anywhere in the world.

Unique Features

The forex market has several advantages over other types of trading, such as traditional stocks:

- **Liquidity.**

The high volumes traded globally lead to high liquidity. The big advantage of liquidity is that you can always find demand to sell or buy the currency pair you wish.

- **Increased leverage.**

Leverage is when you 'borrow' money so that you can use a small investment to get a greater yield. Most stock markets offer 1:2 leverage. With forex, 1:100 and higher is common. This means your opportunities for gain are greatly enhanced. Remember though that your risk increases too.

- **Increased opportunities.**

Forex market conditions can change at any time in response to real-time events. While you must be aware of the risks such changing markets can pose, remember that volatile markets also offer high profit opportunities.

What do you trade?

In forex trading you mainly trade currencies, which are always traded in pairs. There are four major currency pairs (called the majors) which are mostly traded against the US dollar.

They are the euro/dollar (EUR /USD), the British pound/dollar (GBP/USD), the Japanese yen/dollar (JPY/USD) and the Swiss franc/dollar (CHF/USD).

Trading in the four major pairs makes up the majority of the market and the most commonly traded currency pair is the euro/dollar (EUR/ USD).

You can also trade hundreds of other currencies against each other (called cross currencies because the exchange rate is calculated via the US dollar) but remember that the majors are the most liquid.

Who trades?

There are two parties involved in an online forex deal: you as the trader and the market maker. A market maker is a company that facilitates trading by offering an ask and bid price on a currency, literally making the market for traders to trade in.

Individual forex traders like you make up the fastest-growing segment of the global forex market. The other players include the interbank market which is mostly made up of the largest commercial banks and securities dealers, after which you have the smaller banks, multi-national corporations and hedge funds.

When to trade?

Because forex is a truly global market, you can trade 24 hours a day, five days a week. As one region's market day ends, the next region's market day begins. This means you can trade on any region's news as developments take place.

How do I make profit?

You can profit from forex trading by correctly determining whether one currency in a currency pair will go up (strengthen) or go down (weaken) relative to the other currency in the pair. With forex, you can profit whether the market is rising or falling. This is because currencies are traded in pairs. The key is to buy when a currency is low and sell it back once it is high.

Traders develop trading strategies based on technical and fundamental analysis. Technical analysis is the use of charts and other statistical measures to predict future price movements based on past prices, while fundamental analysis looks at how macro-economic data releases, news announcements and other reports may cause rates to change.

What drives forex prices?

As with any marketplace, the main factor behind changes in exchange rates is supply and demand. In the forex market there are however many other factors that cause prices to fluctuate as well. These factors may be of an economic, political or geographical nature. Fundamental analysis explains how you can use these factors to forecast currency rate movements.

How do I use Technical Analysis to trade?

If you've ever seen a forex chart with a lot of lines and waves, then that's technical analysis being applied in gauging where price could go next. The concept behind technical analysis is that past price action may repeat itself, so traders try to observe price patterns in predicting future moves.
There are various tools that can be used to conduct technical analysis. Among these are inflection points, Japanese candlestick formations, chart patterns, and technical indicators.