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Forex for Beginners

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Loss may exceed initial investment

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Table of Content

Day trading involves the buying and selling of securities over a single business day, often on the basis of small price fluctuations. Day trading is most common in foreign exchange because the volatility offers the chance to make a profit in just a short period of time.

However, because of the volatility and speed required to day-trade, it is considered a risky practice. Day trading requires a lot of market knowledge and constant attention, which is why it’s better suited to experts rather than beginners.

In this eBook, we are going to review below topics.

Forex for Beginners:
What is Forex Market?

Key Takeaways

- The foreign exchange (also known as FX or forex) market is a global marketplace for exchanging national currencies.
- Because of the worldwide reach of trade, commerce, and finance, forex markets tend to be the largest and most liquid asset markets in the world.
- Currencies trade against each other as exchange rate pairs. For example, EUR/USD is a currency pair for trading the euro against the U.S. dollar.
- Forex markets exist as spot (cash) markets as well as derivatives markets, offering forwards, futures, options, and currency swaps.
- Market participants use forex to hedge against international currency and interest rate risk, to speculate on geopolitical events, and to diversify portfolios, among other reasons.swaps.

What Is the Forex Market?

The foreign exchange market is where currencies are traded. Currencies are important because they enable purchase of goods and services locally and across borders. International currencies need to be exchanged to conduct foreign trade and business.

If you are living in the United States and want to buy cheese from France, then either you or the company from which you buy the cheese has to pay the French for the cheese in euros (EUR). This means that the U.S. importer would have to exchange the equivalent value of U.S. dollars (USD) into euros.

The same goes for traveling. A French tourist in Egypt can't pay in euros to see the pyramids because it's not the locally accepted currency. The tourist has to exchange the euros for the local currency, in this case the Egyptian pound, at the current exchange rate.

One unique aspect of this international market is that there is no central marketplace for foreign exchange. Rather, currency trading is conducted electronically over the counter (OTC), which means that all transactions occur via computer networks among traders around the world, rather than on one centralized exchange. The market is open 24 hours a day, five and a half days a week, and currencies are traded worldwide in the major financial centers of Frankfurt, Hong Kong, London, New York, Paris, Singapore, Sydney, Tokyo, and Zurich—across almost every time zone. This means that when the U.S. trading day ends, the forex market begins anew in Tokyo and Hong Kong. As such, the forex market can be extremely active any time of day, with price quotes changing constantly.

A Brief History of Forex

In its most basic sense, the forex market has been around for centuries. People have always exchanged or bartered goods and currencies to purchase goods and services. However, the forex market, as we understand it today, is a relatively modern invention.

After the Bretton Woods accord began to collapse in 1971, more currencies were allowed to float freely against one another. The values of individual currencies vary based on demand and circulation and are monitored by foreign exchange trading services.

Commercial and investment banks conduct most of the trading in forex markets on behalf of their clients, but there are also speculative opportunities for trading one currency against another for professional and individual investors.

There are two distinct features to currencies as an asset class:

- You can earn the interest rate differential between two currencies.
- You can profit from changes in the exchange rate.

An investor can profit from the difference between two interest rates in two different economies by buying the currency with the higher interest rate and shorting the currency with the lower interest rate. Prior to the 2008 financial crisis, it was very common to short the Japanese yen (JPY) and buy British pounds (GBP) because the interest rate differential was very large. This strategy is sometimes referred to as a "carry trade."

Why We Can Trade Currencies

Currency trading was very difficult for individual investors prior to the Internet. Most currency traders were large multinational corporations, hedge funds, or high-net-worth individuals because forex trading required a lot of capital. With help from the Internet, a retail market aimed at individual traders has emerged, providing easy access to the foreign exchange markets through either the banks themselves or brokers making a secondary market. Most online brokers or dealers offer very high leverage to individual traders who can control a large trade with a small account balance.

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Forex for Beginners:
Three Ways to Trade Forex

An Overview of Forex Markets

The FX market is where currencies are traded. It is the only truly continuous and nonstop trading market in the world. In the past, the forex market was dominated by institutional firms and large banks, which acted on behalf of clients. But it has become more retail-oriented in recent years, and traders and investors of many holding sizes have begun participating in it.

An interesting aspect of world forex markets is that there are no physical buildings that function as trading venues for the markets. Instead, it is a series of connections made through trading terminals and computer networks. Participants in this market are institutions, investment banks, commercial banks, and retail investors.

The foreign exchange market is considered more opaque than other financial markets. Currencies are traded in OTC markets, where disclosures are not mandatory. Large liquidity pools from institutional firms are a prevalent feature of the market. One would presume that a country's economic parameters should be the most important criterion to determine its price. But that's not the case. A 2019 survey found that the motives of large financial institutions played the most important role in determining currency prices.

Three ways to trade forex as follows

Spot market

Forex trading in the spot market has always been the largest because it trades in the biggest "underlying" real asset for the forwards and futures markets. Previously, volumes in the forwards and futures markets surpassed those of the spot markets. However, the trading volumes for forex spot markets received a boost with the advent of electronic trading and the proliferation of forex brokers.

When people refer to the forex market, they usually are referring to the spot market. The forwards and futures markets tend to be more popular with companies that need to hedge their foreign exchange risks out to a specific date in the future.

How the spot market works

The spot market is where currencies are bought and sold based on their trading price. That price is determined by supply and demand and is calculated based on several factors, including current interest rates, economic performance, sentiment toward ongoing political situations (both locally and internationally), and the perception of the future performance of one currency against another.

A finalized deal is known as a "spot deal." It is a bilateral transaction in which one party delivers an agreed-upon currency amount to the counterparty and receives a specified amount of another currency at the agreed-upon exchange rate value. After a position is closed, the settlement is in cash. Although the spot market is commonly known as one that deals with transactions in the present (rather than in the future), these trades actually take two days for settlement.