The foreign exchange market is global, and it is conducted over-the-counter (OTC) through the use of electronic trading platforms, or by telephone through trading desks. Some shorten the term to “forex” or “FX”.

The OTC market is also known as the “spot”, “cash”, or “off-exchange” forex market. (A spot transaction refers to an exchange of currencies at the prevailing market rate.)

Futures and futures options on different currencies can be traded on centralized boards of trade, or exchanges, such as the CME Group. The spot/cash/OTC/off-exchange forex market is not a market in the traditional sense, because there is no central trading location, or exchange. Rather, it is an interconnected telephone and electronic network of bank traders, dealers, brokers and fund managers for electronic transfers of money from one account into another account.

The interbank market is one in which huge banks, insurance companies, corporations and other financial institutions manage the risks associated with fluctuations in currency rates by trading in large quantities.

The secondary market – the OTC market – has developed more recently, permitting retail (smaller) investors to participate in forex markets. The OTC market has many of the same characteristics of the interbank market but it doesn’t provide the same prices, as the size of trades, and the volumes, are much smaller.

Trading forex is buying one currency while at the same time selling a different currency.

Some companies who do business in other countries use forex markets to convert profits from foreign sales into their domestic currency. Other reasons for trading forex include speculation for profit, or to hedge against currency fluctuations.
SIZE AND DEPTH OF THE MARKET:

Foreign exchange is the largest market in the world, with volume that exceeds commodities, financial futures and stocks by far. The Euro currency volume alone is more than 5 times the entire NYSE. The industry estimates that about $3.2 trillion of turnover occurs daily, on average, in global OTC foreign currency trading. A true, 24-hour-a-day market, 5 days a week, it begins on Sunday at 5:00 p.m. Eastern standard time, and goes through Friday at 5:00 p.m. Eastern time. Forex trading opens in Sydney and moves across the globe through Tokyo, London, and New York time zones.

Investors and traders can respond immediately to currency fluctuations whenever they occur, no matter whether it is daytime or night. They can usually get in or out of the market without waiting for an opening bell or facing a market gap in liquidity that would be normal in stock trading. The forex market is a highly transparent market. That means that all current market information and news are widely accessible to all participants.

THE MAJORS:

Seven currencies are the most actively traded of the world’s monies, and they are called the majors. Here they are listed with their symbols:

€ Euro (EUR)  £ British pound (GBP)
$ U.S. dollar (USD)  C$ Canadian dollar (CAD)
¥ Japanese yen (JPY)  A$ Australian dollar (AUD)
₣ Swiss franc (CHF)

There are hundreds more which can also be traded, of course, including the New Zealand dollar, or “kiwi”, the Mexican peso, and so on.
H O W  C U R R E N C I E S  A R E  Q U O T E D:

Each currency is given a three-letter code which is used in forex quotes. Currencies trade in pairs, and that is how they are quoted. For instance, the Euro versus the U.S. dollar (EUR/USD). Or the U.S. dollar versus the Japanese yen (USD/JPY). A currency can never be traded by itself, it must be compared with another currency.

In example, to “go long” (or, to buy) the Euro versus the U.S. dollar, the trader simultaneously buys the Euro (EUR) and sells the dollar (USD). The first currency referred to in the pair is the base currency, while the second is the counter (or “quote”) currency.

The pair is quoted in units of the counter currency needed to get one unit of the base currency. So, if the quote EUR/USD is 1.285, it means that 1.285 U.S. dollars are needed to purchase one Euro. Currency rates are carried out 4 decimal places in most cases. The last decimal place is called a “pip” or a “point”.

In trading terms, currency pairs are often quoted as bid-ask spreads. This first part of the quote is the amount of the quote currency you will get in exchange for one unit of the base currency – the bid price. The second part of the quote is the amount of the quote currency you must spend for one unit of the base currency – the ask, or “offer” – price.

In the sample above, if the pair was quoted as a EUR/USD spread of 1.2850/1.2852, it means you can sell one Euro for $1.2850 and buy one Euro for $1.2852.

The full exchange rate might not be quoted for both sides of the spread – it would generally be quoted as 1.2850/52. The only number that is not the same for both sides of the spread is the last number.

Unlike in the stock market, there is no restriction on short selling in the forex market (no “uptick rule”) when the market happens to be moving lower. Since forex trading involves buying one currency and selling another, traders have the same ability to trade in a rising market as in a falling market.
WHAT TO KNOW BEFORE YOU TRADE:

Only regulated entities, such as banks, broker-dealers or Futures Commission Merchants (FCMs) and affiliates of regulated entities may enter into off-exchange forex trades with retail customers. You should ask your broker or firm how they are regulated and check with that regulator to verify registration status and background.

Your relationship with your firm is governed by your forex account agreement. Don’t establish an account without reading and understanding it.

Retail, off-exchange forex trades are not guaranteed by a clearing organization.

You will be required to deposit an amount of money – a “security deposit” or “margin” deposit, as a good faith deposit put on hold at your dealer to cover losses. This must occur before you can buy or sell an off-exchange forex contract. A relatively small amount of money can enable you to hold a forex position worth many times the account value. This is known as leverage.

Since leverage allows you to control a much larger amount of currency that the amount of money you have on deposit, it magnifies the percentage amount of your profits and losses. The dollar amount of profits and losses is not influenced by leverage – the profit or loss is the same whether the leverage is 100:1, 25:1 or 1:1. A margin call is an involuntary liquidation of your positions if the account equity falls below the amount of margin set aside by your dealer. Other firms may charge you for losses that accrue that are greater than the amount on deposit. You should check your agreement with your firm to see if the agreement limits your losses.

Some practical next steps would be to attend/view a webinar, try an online forex simulation, or ask your broker for a workbook to see if you understand the way a trade should be set up and calculated and how to maintain a trade log. To learn more, or to get started, contact your broker.

PFG BEST

The BEST thing about our technology is our people.