

BEAR BULL TRADERS

LEARNING COMMUNITY OF SERIOUS TRADERS

FOREX BASICS

Forex

Currency Pairs

Forex Terminology

Spread

Lot Size

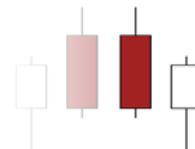
Margin and Leverage

Pip Value

Volume

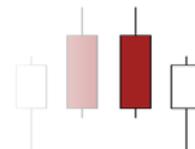
WHAT IS FOREX TRADING?

- Forex = Foreign Exchange
- Forex Trading = Buy or Sell **contracts** for a currency pair based on fundamental and technical prediction
- Buy or sell one currency in the exchange for another currency
- Forex pair contracts (not the actual currency bills)
 - Small variation in the exchange rates
 - Limited capital of individuals (need **Leverage**)→ Need high capital to profit from these small variations (**pip**) in the rate



CURRENCY PAIRS

- Currencies are traded in the form of pairs. Stocks are traded as individual instruments
- Currency names (most common):
 - **USD**: US dollar | Greenback
 - **EUR**: Euro | the European Union currency
 - **GBP**: British pound | “Cable” refers to GBPUSD
 - **CAD**: Canadian dollar | Loonie
 - **AUD**: Australian dollar | Aussie
 - **NZD**: New Zealand dollar | Kiwi
 - **JPY**: Japanese Yen
 - **CHF**: Swiss franc | Swissi



CURRENCY PAIRS

- Currency pair: a mixture of two currencies reported side by side



- We buy or sell the **base** currency at the expense of the **counter** currency
- Buy EURUSD: buy Euro and sell proportional (by exchange rate) US dollar → we are **long** Euro and **short** USD at the same time
- Sell EURUSD: sell Euro to buy proportional US dollar → we are **short** Euro and **long** USD at the same time

CURRENCY PAIRS

- Currency pairs
 - Major: these pairs have USD on one side of their
 - Cross: these do not have USD in their symbol
 - Most common major and cross currency pairs traded in the forex market:

| Major Currency Pairs | Cross Currency Pairs | |
|----------------------|----------------------|---|
| EURUSD | Euro crosses | EURGBP, EURJPY, EURAUD, EURNZD, EURCAD |
| GBPUSD | GBP crosses | GBPJPY, GBPCHF, GBPCAD, GBPAUD, GBPNZD |
| USDCAD | CAD crosses | CADJPY, AUDCAD, NZDCAD |
| AUDUSD | AUD crosses | AUDJPY, AUDCAD, AUDNZD |
| NZDUSD | NZD crosses | NZDCAD, NZDJPY |
| USDJPY | | |
| USDCHF | | |

- Major pairs: highest liquidity, actively trades, lowest **spread**
- Highlighted cross pairs show the most common

FOREX TERMINOLOGY

- **Pair:** refers to the currency pair that contains the base and counter currency in its name; sometime is called the *instrument* or the *market* (specific to that currency pair)
- **Pip:** unit of measurement, or the smallest number to represent the change in the value of exchange rate for a pair
 - Normally is the 4th decimal point of the quoted price except for JPY pairs (JPY pairs: the 2nd decimal point is the pip)
- **Spread:** difference in the price of buying and selling a currency pair (similar to bid and ask difference in stock trading)
- **Lot size:** number of currency pair units being traded. Typical size of lot:
 - Standard: 100,000 contracts
 - Mini: 10,000 contracts
 - Micro: 1,000 contracts
 - Nano: 100 contracts

FOREX TERMINOLOGY

- Example of a typical currency pair quote

Fractional pip

pip

SELL 0.02 BUY

1.0766⁵ 1.0772⁵

The lot size: a multiple factor of the standard lot
 $0.02 \text{ lot} = 0.02 \times 100,000 = 2,000$

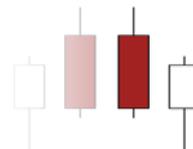
The left price is the sell price
The right price is the buy price
Difference is spread:
Spread = $1.07725 - 1.07665 = 0.00060$
Or $0.000060 = 6.0 \text{ pips}$

FOREX TERMINOLOGY

- **Leverage:** the ability to buy or sell a large amount of an instrument using a small amount of your own money
 - Without leverage, we can only buy or sell a standard lot with exact 100,000 dollars/euro of our base currency
 - Leverage allows us to buy/sell each pair with a fraction of the lot size
 - Leverage of 100:1 allows us to buy/sell a standard lot (100,000 contracts) with only \$1,000
 - Leverage is a double edged sword
 - If the original standard lot (100,000) rises in price to give us \$101,000, then we made 100% profit because we only used \$1,000 of our own money.
 - If our investment on the standard lot goes against us and becomes \$99,000, then we have lost all our money.
 - Different brokers offer different leverage, most common ones are:
 - 50:1
 - 100:1
 - 200:1
 - 500:1

FOREX TERMINOLOGY

- **Margin:** the amount of money you have to put from your own pocket to be able to use the leverage offered by your broker
 - In the case of 100:1 leverage, the \$1,000 that we have to put as our initial investment is the required margin in order to be able to use the leverage to buy/sell a standard lot size (100,000)
- Your broker determines the minimum margin required to trade each currency pair. This is normally indicated by the margin percentage
 - Example: Minimum 5% margin required to trade EURUSD means you have a leverage of 20:1 for this pair.
- Your broker always shows you the **used margin** on your trading platform. This is the amount of money your broker has locked in your currently open trades.



PIP VALUE

- Most traders report their trading results in terms of number of pips gained/lost for a trade or during a certain period of time.

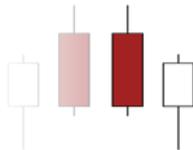
Why?

Because pip is the only sensible measure that could be translated among forex traders.

Example: I made \$400 profit on the EURUSD long trade from 1.2200 level with a 40 pip stoploss. Does it mean that you would have made the same amount of money if you entered that trade with me?

Answer is “I do not know” or most likely “No”. It all depends on your pip value. **How?**

- **Pip Value:** the value of a pip allows you to determine the equivalent dollar amount based on your trading platform and broker conditions.
 - Pip value is the equivalent dollar (or euro, yen, etc.) of a pip based on your trading allowance



PIP VALUE – CONT.

- How to calculate pip value? You need the following parameters
 - Exchange rate (your account currency to the counter currency of the pair)
 - Lot size

$$\text{pip value} = 1 \text{ pip} \times \frac{\text{lot size}}{\text{exchange rate}}$$

Example 1:

1 Standard lot of EURUSD

USD as the account currency

EURUSD rate is 1.2700

Pip value = $0.0001 \times 100,000 / 1 = \10

Example 2:

1 Standard lot of EURUSD

EUR as the account currency

EURUSD rate is 1.2700

Pip value = $0.0001 \times 100,000 / 1.27 = €7.87$