MYTRADING SKILLS

FOREX TRADING GUIDE

A comprehensive introduction to forex trading for beginners.

Learn why people trade forex, what trading forex is and how you might make money doing it.

Learn the skills you need to make money trading the markets with My Trading Skills.

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Learn the skills you need to make money trading the markets with our programme of live courses.

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We've got lots of seriously insightful free materials: dozens of free on-demand courses, 100+ expert insights, an extensive trading glossary, the MYTS Spread Betting Guide and our market analysis posted on YouTube – subscribe to our channel to get notified when new videos are released.

Expert Community

The MYTS Community is a revolutionary online platform for new and experienced traders looking to share ideas and make profits.

Guide Chapters

Foreword

From MYTS Head Tutor, Phillip Konchar

Every day, huge numbers of brand-new traders start trading for the first time on the Foreign Exchange markets (also called Forex, or FX for short).

More often than not, they were attracted to Forex because they believe trading currencies are an easy way to make fast profits, diving right in without first educating themselves about how it actually works. Don't make the same mistake.

Even if you think you know, or have an idea, of how Forex trading works, it's still important to get the best trading education possible. Even experienced traders keep learning and bettering themselves. Why? Because the financial markets are constantly evolving, and trading knowledge can always be improved upon.

We've packed this guide full of fantastic insights and nuggets of valuable information to set you on the right course, so please take the time to read it in full.

We've tried to go into as much detail as possible but if there are topics we cover more extensively in our free or premium courses we'll tell you where you can find out more.

Happy trading!

Phillip Konchar
MYTS Head Tutor

Chapter 1 – Why is Forex Popular?

The Forex markets are the largest – by dollar value of trading volume – and most liquid financial markets in the world. Trading Forex is, indeed, immensely popular.

Forex trading on a wide scale sprang up along with the rise of the internet, which enabled brokers to offer individual retail traders access to this asset class, something that had previously been limited to large institutional traders such as banks and hedge funds.

The internet provided retail traders with easy access to the markets and online trading platforms to facilitate trading.

Forex trading has exploded in popularity since the turn of the century for several reasons, including:

- Easy access: low entry costs
- Leverage
- Continual trading opportunities
- High liquidity: low bid-ask price
- Ease of short selling

Easy access for small traders

One of the main attractions of Forex trading is that it's an asset class that small traders can easily enter.

You might think that becoming a "currency trader" requires a lot of start-up capital – but it doesn't.

Getting started in Forex trading doesn't require anywhere near the kind of capital that it takes to start investing in stocks or commodity futures. The Forex markets feature very low entry costs. Many traders open a Forex trading account with initial deposits of just $50 to $100.

How is it that Forex trading requires so little capital?

The Forex markets feature very low entry costs

The answer to that question brings us to the second reason why so many people trade the Forex markets…leverage.

The power of leverage

What makes it possible for traders to operate in the Forex markets with just a small amount of trading capital is the unprecedented amount of leverage that's available in Forex trading – up to 1000:1 leverage in some jurisdictions.

High amounts of leverage translate into magnified returns

The high amount of leverage available is further enhanced by the fact that Forex brokers commonly offer trading in mini- and micro-lots. A mini-lot is one-tenth (1/10) the size of a standard lot, and a micro-lot is one-one hundredth (1/100) of a standard lot.

Even some of the most highly-restricted Forex trading – that's regulated by the EU – offers up to 30:1 leverage.

Using leverage that only requires traders to put up a small margin deposit to take a trading position means that Forex traders can, for instance, buy or sell short five micro-lots with a margin deposit of only about $5.00.

High amounts of leverage translate into magnified returns.

For example – leverage working for you

A trader who traded in five micro-lots of EUR/USD with only a $5 margin deposit could double that $5 from just a 10-pip move in the market. If the market moved 100 pips in the trader's favour, their $5 upfront commitment would earn him a $50 return.

A trader trading standard lot sizes might have to put up 100 times more in margin money, but that's still a relatively small amount of capital – just $500 to trade five standard lots. Now what would their profit be from a 100-pip move in their favour? – $5,000! ($10 x 100 x 5 lots = $5,000)

That's a $5,000 profit, from a $500 investment.

But…traders do need to keep in mind that just as it magnifies profits, leverage also magnifies losses in equal measure, and a trader can lose more than their original margin amount put up for the trade.

Learn more: Take our free Margin Trading Demystified course & Mastering Trading Risk course

Opportunities

Another major attraction of Forex trading is the continual opportunities to make trading profits. The currency markets trade 24 hours a day, five days a week, and the markets are actively traded throughout each day.

Did you know

The average daily trading range for the major currency pairs – EUR/USD, GBP/USD, USD/JPY, and AUD/USD – is typically 80 to 100 pips. Depending on what lot sizes they're trading, a Forex trader can realise a substantial profit on as little as a 10 or 20 pip fluctuation in the exchange rate of a currency pair.

Forex traders can trade every trading day. The possibility of earning a good day-to-day living attracts many people to the Forex markets. The high volume of trading in the Forex markets makes for a very liquid market where bid-ask spreads are attractively low.

Combined with minimal commission charges, this means Forex trading offers very low transaction costs when compared to other investment instruments.

Trading opportunities in the Forex markets are further amplified by the fact that in Forex trading it is just as easy to sell short as it is to buy long. There are no restrictions on short selling like those in stock trading.

Traders can profit just as easily from falling market prices as from rising market prices.

A relatively easy market to learn

For traders new to Forex trading, it takes some time to learn how to trade the Forex markets – just like it takes time to learn how to invest in stocks, options, futures, or any other investment vehicle. But the immense popularity of Forex trading has generated a wealth of educational resources.

Learn more: Take our premium Trading for Beginners course

In summary

There are a lot of factors that make people interested in trading the Forex markets.

This includes low capital requirements that make it easy for even the smallest of small traders to get started; a 24-hour market that continually offers new trading opportunities; low transaction costs; ease of selling short; and readily available trading educational resources.

One more advantage Forex trading offers is its relative simplicity as compared to other asset classes.

There are only a handful of major currency pairs that a trader needs to familiarise themselves with. Once they do, picking and choosing among currency pairs to trade is a lot less complicated than, say, choosing investments from among thousands of stocks.

Forex trading offers investors a wealth of advantages and opportunities.

Chapter 2 – Why Forex is or isn't for you?

So, you might like the idea of being a Forex trader, but it is not right for everyone.

Back in 2016 the UK's Financial Services regulator, the FCA, conducted a review of retail trading – not just Forex, but all types including CFD trading and binary options – and found 82% of retail traders lost money. Trading is a zero-sum game so there are going to be winners and losers but this ratio led us to two conclusions:

- This underscores the importance of working out if Forex is right for you…before you consider risking your money on it.
- It means the 18% balance must either breakeven or be profitable – about 1 in 5.

We've pulled together the reason's traders should and shouldn't be trading Forex for. All aspiring Forex traders should be asking themselves their reasons for getting into Forex trading before they get started.

If you can honestly say it's for the right reasons, and not the wrong reasons you'll have a much greater chance of making a success of it, of being in the 1 in 5 group of traders, over the long term.

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5 reasons why you shouldn't trade Forex

#1 You trade with money you can't afford to lose

Because the market can be volatile, there is always the risk of losing money when trading a currency pair.

In addition to the inherent risk linked to trading, with Forex trading you need to add margin trading and leverage, which means that you can trade large amounts with little initial capital.

So, this high level of risk means that you need to be sure that you do not use money that you need to live on – it sounds an odd thing to say, but make sure you always trade with money you can afford to lose!

#2 You don't know what you're doing

Before even considering trading, you need to know the basics of the markets, what influences them, and how trading works.

Another important aspect is you need to have a trading strategy that suits your trading style, with strict money management and risk management rules that govern how you allocate your funds to trades.

If you have no trading experience, and you do not know how markets work and relate to each other, Forex trading might not be right for you – at least not yet.

#3 You can't handle when you're wrong, or when you're losing

When making trading decisions, you can be right and make money, but you can be wrong and lose money.

That's fine – as long as your profits are higher than your losses. Losing trades are part of the trading game – you need to be prepared for this and not take it personally!

In Forex trading, you need to quickly recognise when you're wrong, and close losing trades as early as possible. It's important to develop your ability to accept your losses and learn from your trading experience.

But do remember, it's ok to be wrong – you can't be right 100% of the time in every single trade you execute. And if you can't handle losing, you won't be able to be profitable in the long run.

#4 You're risk-averse

Fast-changing market conditions, high volatility, and leverage can make Forex trading a high-risk activity.

You can make huge returns in the FX market, but these kinds of returns do not come without risks, especially when using leverage.

So, if you're generally a risk-averse person, Forex trading is not going to fit your personality.

#5 You don't have time

There are several trading styles you can use when trading currencies, each requiring a certain amount of time in front of the screens.

For example, you can use a trend following method, or position trading strategy, which will require less time than short term trades, like scalping or day trading.

Keep in mind that learning about trading, the Forex market and how to develop the right trading plan takes time. You'd better be sure you have time to dedicate to this activity before starting to trade in currency pairs.

5 Reasons you should trade Forex

#1 You like the idea of trading at any time you want

The Forex market is open round the clock, which allows you to trade whenever you want.

It provides great flexibility for traders who want to trade part-time and as there are no market opening or market closing times the opportunity for potential profits is 24 hours per day, 5 days per week!

Of course, trading volume varies depending on how many sessions overlap, and it often decreases when there are bank holidays in major sessions such as on Wall Street.

#2 You like technical or fundamental analysis

Forex trading is often geared towards technical analysis, so if you have sound knowledge of price study, charting and technical patterns, Forex trading might be a good fit for you.

While using technical analysis, you may find it useful to use economic calendars, such as the U.S. Market Economic Calendar, or the Global Economic Calendar.

The impact of news is also strong on the Forex market, as currencies quickly react to macroeconomic news, political events and economic data.

So, as a Forex trader, you should monitor the economic calendar for fundamentals to determine when currency pair prices might accelerate and break important levels thanks to higher volatility.

#3 You can deal with a high-risk environment

As the Forex market can be a volatile market, you'll need to be able to tolerate a certain level of risk. To better protect your trading capital, it's important to have a sound risk and money management system with rules to follow.

For instance, you should always determine your stop-loss and take-profit levels before entering the market. In this way, you'll already know how much you're willing to lose and how much you can expect to earn from your position. This is called your "risk/reward" ratio.

Another example would be to adapt the size of your positions depending on the current trading conditions and the evolution of your trading capital. All these rules should be part of your trading plan and to be profitable, you should always stick to your plan!

#4 You are dedicated and patient enough to develop a trading plan and follow your method

Commitment, patience, and dedication are the most important ingredients in trading.

Having a trading plan to follow when trading is vital if you want to be successful, but most importantly you need to be committed to follow it, and patience to open/close your positions according to your set-ups.

You need to develop your strategy first, or trading system, before trading real money on the Forex markets – if not, how do you know what you're doing, and that what you're doing is making money?

A trading plan is a description of your trading method:

- Trading style: scalping, day trading, swing trading, position trading
- Currency pairs: majors, minors, exotics
- Timeframes 5 min chart, 15 min chart, 4h chart
- Size of your positions
- Set-ups to follow to enter/exit the market
- Risk and money management rules: risk/reward ratio, stop-loss and take-profit orders

#5 You want to take advantage of a growing market with high liquidity, volatility and leverage

The Forex market has been a fast-growing market over the last 20 years. According to the 2016 Triennial Central Bank Survey of FX and over-the-counter (OTC) Derivatives Markets from the BIS, trading in foreign exchange markets averaged $5.1 trillion per day in April 2016.

This high trading volume increases the liquidity of the market, which means that it's easy and fast for a trader to enter a trade and also reduces the risk of potential price manipulation from others.

Forex trading also uses leverage that can magnify your returns (as well as your losses) in a very short period of time. This leverage allows you to manage more money than you currently have in your trading account for potentially higher profits.

Rule of Thumb

Deciding whether to trade or not to trade the Forex markets is up to you, but remember that even if you're one of the smallest actors on the Forex market, you can still profit from it.

Take your time going through your reasons for wanting to trade and you're doing it for the right reasons – if you are it is more likely you'll make a success of it.

If you want to take advantage of Forex trading, it's a good idea to use a demo account before risking real money in your trading account.

There is very little chance that you can be successful without trying out your broker's trading platform first. This includes real-time charts and trading tools, its trading conditions to test your own trading system.

Chapter 3 – How Forex Works

The Forex markets are some of the most exciting to trade. They are the largest and most liquid, open 24 hours a day from 10 p.m. GMT on Sunday until 10 p.m. GMT on Friday, and you can take advantage of them from almost any country.

So, ready to jump into the world of Forex? Great!

We're at the start of Part II of our guide, in it, we'll explain exactly what Forex trading is, how it works, its history and how traders access it. First of all, in this chapter on How Forex Works, we're going to introduce some key concepts and go through the basics.

Learn more: Take our premium Trading for Beginners course

What is a currency pair?

Governments, banks, companies and individuals need foreign currency every day. This might be businesses buying stock from an overseas supplier, a bank hedging its exchange rate risk or an individual going on holiday and needing some spending money. Whether directly or through intermediaries like brokers these parties all come together to buy and sell currencies – this creates the market and the price you see on your trading screen.

When trading Forex, you're trading currency pairs – what this means is you are buying one currency and selling the other so the price you see is the price of one currency relative to the other.

Every currency union, normally a country, has a currency – US Dollars for the United States, the Euro for the Eurozone, Pound Sterling for the United Kingdom, Yen for Japan, Renminbi for China and so on.

Exchange rates can either be floating – meaning free to change from one moment to the next or pegged to another currency, or a basket of currencies – meaning that the value of the exchange rate is at a fixed rate, such as the Saudi Riyal which is pegged to the U.S. Dollar at 3.75. The largest quoted currencies – like EUR/USD and USD/JPY – are floating.

It's always quoted in pairs

Because one currency is being bought and one sold exchange rates are always quoted in pairs. When trading Forex markets, we're always concerned with currency pairs, not just a single currency. Let's look at a price for the EUR/USD pair – the Euro and the US Dollar.

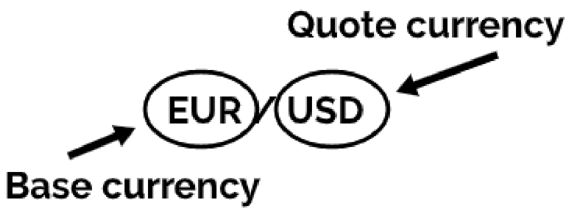
EUR/USD pair price

What this is telling us is you can sell 1 euro and buy about this number of dollars. You can also sell about this number of dollars to buy 1 euro.

Note: we'll go into why it is only 'about' in a moment when we talk you through Bid and Ask prices.

Base currency and quote currency

The price of a currency pair is always quoted using the same convention: the first currency in the pair is called the base currency and it is always worth 1, while the second currency is called the quote currency and shows how much of the quote currency you'll exchange for 1 unit of the base currency.



Quote & Base currency

Majors, minors, and exotic currency pairs

Theoretically, you should be able to trade any currency in the world with any other. However, you'll only have access to those offered by your Forex broker.

There are 6 currency pairs that account for more than 80% of total Forex trade

The 2016 Triennial Central Bank Survey from the Bank For International Settlements (BIS) shows that the USD is the dominant currency, as "it was on one side of 88% of all trades in April 2013 to April 2016".

The EUR, the JPY, and emerging market currencies such as the Renminbi or the Mexican peso are also counted amongst the most traded currencies, while the EUR/USD and the USD/JPY are among the most traded currency pairs.

There are three broad classifications for currency pairs.

Majors

These are the 6 currency pairs that account for more than 80% of total Forex trade. The major currency pairs are:

- EUR/USD – Euros/US dollar
- USD/JPY – US dollar/Japanese yen
- GBP/USD – British pound/US dollar
- USD/CHF – US dollar/Swiss franc
- AUD/USD – Australian dollar/US dollar
- USD/CAD – US dollar/Canadian dollar

Exotics

An exotic currency pair usually consists of one major currency against a currency from a smaller or emerging economy:

- CHF/HUF – Swiss franc/Hungarian forint
- GBP/CZK – British pound/Czech koruna
- EUR/TRY – Euro/Turkish Lira
- JPY/NOK – Japanese yen/Norwegian krone
- NZD/SGD – New Zealand dollar/Singapore dollar

Minors

Minors, also called crosses, represent currency pairs that are less traded and do not contain the US dollar – but they do contain a major currency:

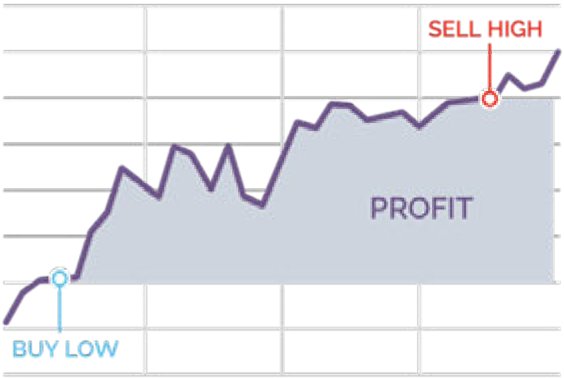
- GBP/MXN – British pound/Mexican peso
- SGD/JPY – Singapore dollar/Japanese yen
- EUR/GBP – Euro/British pound
- EUR/AUD – Euro/Australian dollar
- GBP/JPY – British pound/Japanese yen
- CHF/JPY – Swiss franc/Japanese yen
- NZD/JPY – New Zealand dollar/Japanese yen
- GBP/CAD – British pound/Canadian dollar

Are you bullish or bearish?

So you now know how a currency pair's price is displayed. From there, you have two trading opportunities: either you open a buy position, or a sell position on the currency pair.

If you think EUR is likely to increase in value against USD – that would mean the price you are seeing quoted will go up – then you would buy the EUR/USD currency pair, or "go long". What you're doing here is buying euros and selling dollars. At this point in time you are bullish EUR and bearish USD.

You're expecting the euros you are now the proud owner of to appreciate in value – the EUR/USD price will go up – and you sell them back, buying dollars at a later point in time for a better rate and booking a profit.



Buying Low, Selling High

Buying High, Selling Low

Conversely, if you believe that the EUR is likely to weaken against the USD, then you would sell the EUR/USD, or "go short". You would be long dollars and be anticipating the EUR/USD price to fall.

Selling High, Buying low

Selling Low, Buying High

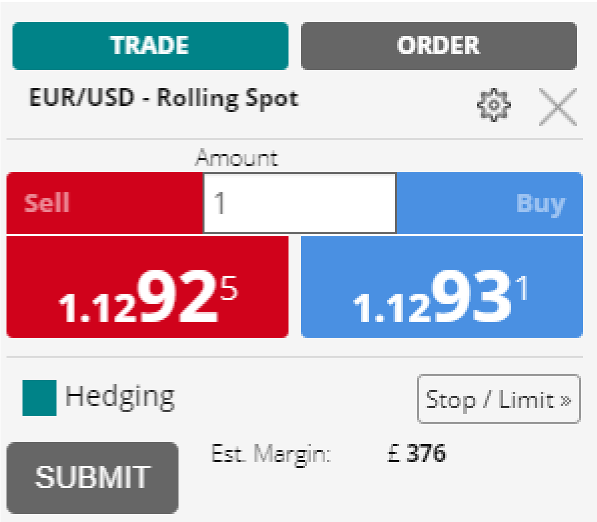
Whether you'll make profit or loss depends, naturally, on whether you were correct in your prediction.

Don't worry if this hasn't sunken in yet, we'll run through several worked examples later in the guide.

Bid and ask prices

However, it is not as simple as going long or short at a single price. Here is a real deal ticket. As you can see, there are 2 prices displayed: a sell price at $1.12925, also called the bid price, and a buy price at $1.12931, also called the offer or ask price.

The bid price is the price to open a short position. The ask price is the price to open a long position.



Real deal ticket example

Spread

Here is a list of all the Euro linked currencies we've clipped from a trading platform.

Market	Sell / Buy	
EUR/AUD - Rolling Spot	1.61003	1.61021
EUR/CAD - Rolling Spot	1.51059	1.51078
EUR/CHF - Rolling Spot	1.08156	1.08172
EUR/GBP - Rolling Spot	0.88839	0.88845
EUR/JPY - Rolling Spot	122.444	122.454
EUR/NZD - Rolling Spot	1.72253	1.72281
EUR/USD - Rolling Spot	1.13032	1.13038
EUR/ZAR - Rolling Spot	18.8941	18.9091

You'll notice that the buy price is always higher than the sell price (ask price > bid price). The difference between these 2 prices is called the spread, on our EUR/USD deal ticket it is 0.00006 (1.12931 minus 1.12925).

It is a bit of a stretch to get your head around if you're coming across spread for the first time but this is one of the ways traders pay the market to trade – its a cost of trading. The wider the spread the more it costs, the narrower the cheaper it costs – all other things being equal.

Learn more: Take our free Breaking Down Trading Costs course

Pips

Pips are used to measure the movement in Forex prices.

Pip stands for Point in Percentage

For the large majority of currency pairs, a Pip is the 4th decimal place. The one exception being the Japanese Yen, with a Pip at 2 decimals.

So, if EUR/USD moves from $1.12925 to $1.12935, then it has moved one Pip.

Don't get confused when you see a currency quoted, it is not always the last number that is the Pip – our example deal ticket had five decimals. It doesn't matter how many decimals are displayed – a Pip is still the fourth decimal.

Lots

Contracts for currency pairs come in a standard size, called lots.

A standard lot is for 100,000 units of the base currency.

Going back to our EUR/USD example, if you went long 1 lot of EUR/USD, using the ask price of $1.12931, you are buying €100,000 and selling $112,931.

Not everyone wants exposure to 100,000 units of a currency, so retail brokers offer smaller contract sizes:

- Standard lot: 100,000 units of the base currency
- Mini lot: 10,000 units of the base currency
- Micro lot: 1,000 units of the base currency
- Nano lot: 100 units of the base currency

Value per Pip

When we know the size of the contract, we can work out the value per pip in the quote currency. To do this we take the contract size and multiple it by one pip.

For our EUR/USD example, 100,000 x 0.0001 = $10.

So, if EUR/USD moves from $1.12925 to $1.12935, and you are trading 1 lot then that move is worth $10. Whether it is a profit or a loss, obviously depends on whether you are long or short.

Stop orders

Stop orders are where you instruct your broker to place a buy trade at a price higher than the current price, or a sell trade lower than the current price.

Stop-loss orders are closing orders at a price level that represents a certain amount of loss, in case the market moves against you. This will limit your potential loss on the trade to an amount you are comfortable with. With a standard stop order, if the market hits your stop price, then your trade will automatically be closed out at the best available market price.

This does not guarantee that your order will be filled at the exact price level of your stop, only that it will be filled at the best price available when triggered. If the market is moving rapidly or is closed but reopens at a price that then triggers your order, your trade might be filled at a substantially different price. This fluctuation in order fill price is known as "slippage".

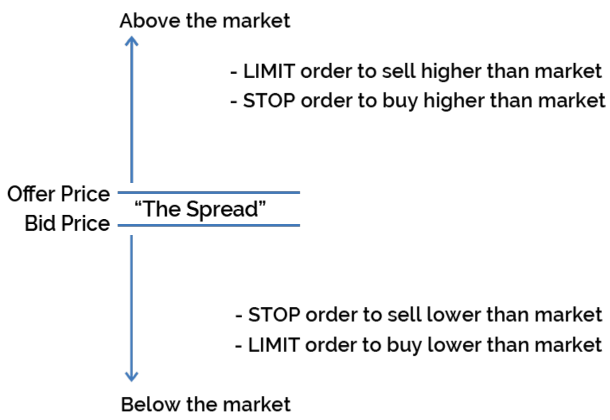
If you want to be assured of avoiding market slippage, then you can pay a small premium to place a "guaranteed stop-loss order". With a guaranteed stop, you are guaranteed to have your trade closed at the exact stop-loss price level you specified in your order.

Limit orders

Limit orders are where you ask your broker to place a buy trade at a price lower than the current price, or a sell trade higher than the current price.

You can set a closing limit order to automatically close out your trade if the asset you're trading reaches a certain level of profitability.

If you ever get confused with the terminology, here is how to remember how limit and stop orders work:



How limit & stop orders work

Margin

Now, even with brokers coming up with smaller lot sizes having to have that sort of capital is limiting. We've got a whole chapter dedicated to margin trading later in the guide so we won't give a detailed explanation here. For now, you just need to know that when trading Forex your broker will not require you to fully fund the position you take on. Your broker will "lend" you a certain percentage of a given position's value, with your own funds being used as a deposit – this deposit is called margin.

Learn more: Take our free Margin Trading Demystified course

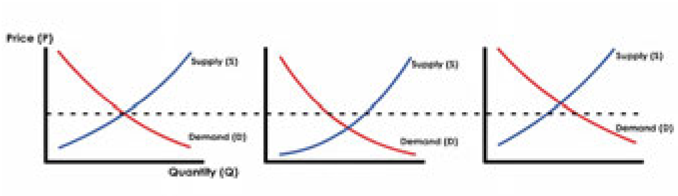
What moves the FX market?

Now we've got a good understanding of some of the basics of currency trading, what actually makes a currency pair's price move?

What we are doing as Forex traders is analysing the relationship between supply and demand.

If the demand for a given currency increases, or if the supply of the currency in the economy decreases for whatever reason, then the price of this currency will tend to strengthen – and vice-versa.

Anyone that has studied economics will recall these diagrams:



Considerations that can affect demand levels

There are considerations that can affect the demand levels of a given currency:

- **short-term** (interest rates, volatility, market sentiment)
- **medium-term** (geopolitical risks, economic growth, employment situation, fiscal policy)
- **long-term** (terms of trade, purchasing power parity)

Keep an eye on the economic calendar

The economic calendar helps you keep an eye on the most important publications, reports, statistics and speeches that can impact currency exchange rates and create profitable trading opportunities.

Did you know

Better than expected statistics can positively impact the supply and demand relationship, as traders prefer to invest in strong and promising economies.

Even if you use technical analysis to make your trading decisions, it is important to know the fundamental events that can increase volatility and the risk appetite in the financial markets.

Keeping abreast of current events will help you avoid being surprised if there is a strong movement on the currency pair you are trading.

Learn more: Take our free How Traders Find Opportunities course

To sum up

We've covered lots in this chapter, so when you next open up a Forex trading platform you'll have a really good appreciation of what it is you are seeing – please go back over anything you don't fully understand – **Forex traders need to know these basics like the back of their hands.**

You should now have a good understanding of the main aspects of Forex trading, from the basics around how a currency pair is priced to how its price movements are measured in Pips, through to how to work out the value per Pip of a lot. fundamental events that can increase volatility and the risk appetite in the financial markets.

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Chapter 4 – Popular Currencies

The Forex markets are some of the biggest and most liquid in the world, with a total daily average trading volume of USD 5.1 trillion in April 2016, according to the Bank For International Settlements (BIS).

When you stop and think of all the companies, governments, banks, and individuals that need foreign currency you start to understand the scale of it.

The market most of these participants come together and exchange currencies in is called the spot Forex market. The standard for delivery of the currencies – into the respective parties' accounts – is 2 days after the transaction.

Spot Forex is an over the counter (OTC) market. This means there is no one central exchange, like in stock trading, that you must run all the trades through. Trades are simply agreed between the two parties transacting. For retail traders, this is your broker – when you buy a currency, the broker sells it to you.

OVER THE COUNTER

BUYER ●●●●●●●●●●●●●●●●●●● SELLER

This means spot Forex is traded from the world's financial centres. In terms of where the trading actually takes place, most trading activity is concentrated within 5 centres:

- London – United Kingdom
- New York – United States
- Singapore
- Hong Kong
- Tokyo – Japan

These sale desks intermediated 77% of all currency trading in April 2016, according to BIS statistics.

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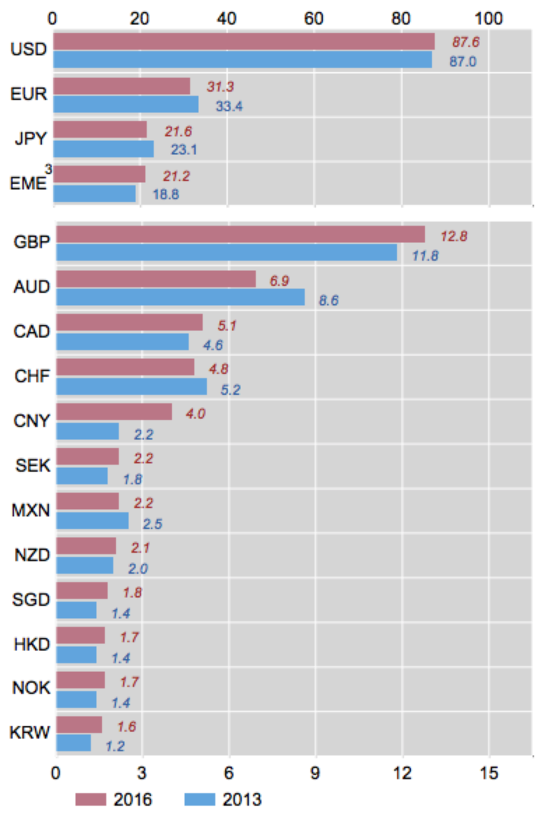
The most-traded currencies

The chart below is from the Triennial Central Bank Survey of the BIS, which represents the daily averages in April 2016 of the Forex Exchange market turnover by currency pairs between 2013 and 2016, net-net basis, in per cent.



Most-traded currencies

Let's look at the top three in a bit more detail.

#1 The American Dollar (USD)

Featuring in nearly 88% of all currency transactions, there are several reasons why the American Dollar is by far the most traded currency in the world.

Going back in history, as part of the new world order after the end of the Second World War, the USD became [the world's reserve currency] with the [Bretton Woods Agreement] in 1944, when all foreign currencies were pegged to it.

At that time, the USD was the only currency convertible in Gold, which makes it the standard unit of currency in the international commodity market today, especially with Gold and Oil – when you see the prices of these they are always quoted in USD for this reason.

It's a trustworthy, stable, and reliable currency, which makes it the most used in international transactions. The American Dollar is widely accepted throughout the world as a medium of exchange, and a means of payment, in many countries.

Did you know

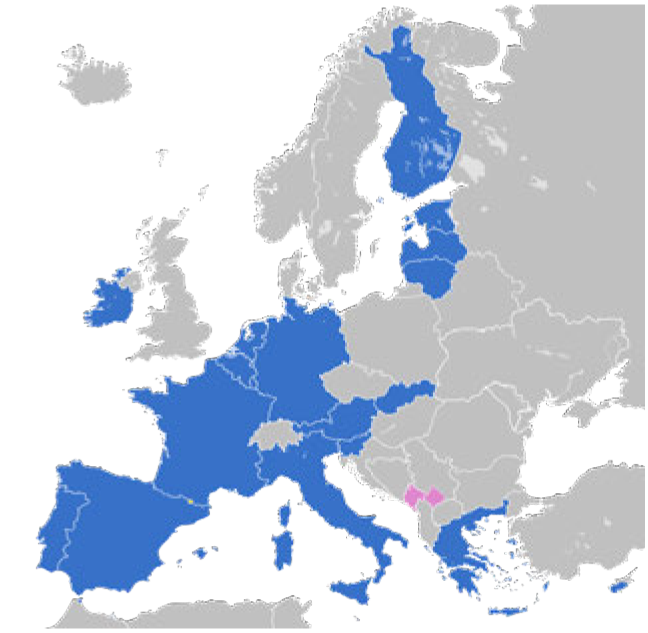
As an example of the American Dollar's supremacy, a few nations besides the U.S. use the U.S. Dollar as their official currency, such as El Salvador, Panama and Ecuador. This is a process called dollarization.

#2 The Euro

The Euro is the 2nd most traded currency, and the 2nd largest reserve currency.

While it was introduced on January 1st, 1999 to 11 countries, it is now the official currency of 19 countries within the European Union, consisting of Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain. Collectively this group is referred to as the Eurozone.

Countries using the Euro



Not all EU member states have the Euro as their main currency, but over 337 million EU citizens now use Euro coins and notes.

In addition, more than 20 countries outside the Eurozone have pegged their currencies to the Euro in order to stabilise their exchange rates, such as Bulgaria, Bosnia, and about 15 African countries.

#3 The Japanese Yen (JPY)

The Yen, the official currency of Japan, is the 3rd most traded currency.

It's also the most liquid currency in Asia, and the 4th most important reserve currency in the world (after the U.S. Dollar, the Euro, and the Pound Sterling), especially for Asian countries.

Even though the country has very high debt levels and no longer has a high growth economy, Japan seems to provide more stability than the majority of the other world economies.

For this reason, traders are confident in its economy, and the Yen is seen as a safe haven in times of [high volatility and uncertainty].

The Yen carry trade is among the most well known and popular currency carry trade strategies among traders – this is where traders will borrow Yen because of the low-interest rate in order to buy currencies with higher interest rates, making profits on the difference.

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Popular currency pairs

The US Dollar, Euro, Yen and the other popular currencies combine as pairs to make the Majors, as described earlier in the guide. The most traded currency pairs between April 2013 and April 2016 were the EUR/USD, representing 23% of all transactions, followed by the USD/JPY, and the GBP/USD, which represented 17.7%, and 9.2% of the transactions respectively.

Growth of the Dragon

In April 2016, the Chinese Renminbi (RMB) became the 8th most traded currency, and overtook the Mexican Peso as the most traded emerging market currency. There is little doubt the RMB, if eventually allowed to freely trade, will become part of the Majors.

So, which currency pairs are worth trading?

This all depends on the type of trader you are.

For the short term

For instance, a short-term trader will focus on the most traded currency pairs with the tightest bid/ask spread.

For the long term

On the other hand, a longer-term position trader will not necessarily look for the most liquid or volatile currency pairs.

Carry trading

Same goes for those who make currency carry trades. This method focuses on the rate differential between the 2 currencies with the aim of making profits based on said difference, as opposed to trying to get the best entry and exit points possible.

Chapter 5 – History of Forex

The Forex markets are some of the largest financial global markets, but it wasn't always like that.

Due to its international nature, Forex traders should be aware of the major events that have shaped international monetary systems, the development of which ultimately allowed us to become currency traders today.

One of the most important events in the history of the Forex market is the creation and implementation of the Gold standard monetary system back in 1871.

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Before the Gold Standard

Before the inception of this international monetary system, countries around the world would use Gold (and, to a lesser extent, Silver) to trade and settle their payments.

Take out a note from your pocket

If you have a British banknote have a closer look at it. It will say 'I promise to pay the bearer on demand the sum of five/ten/twenty/fifty pounds. The note is signed by the Chief Cashier of the Bank of England.

This harks back to this era when the note could be exchanged at the Bank of England for ten pounds of Sterling Silver, hence the currency's name – Pounds Sterling.

This means that the value of these commodities – the Sterling Silver and Gold – was strongly influenced by changes in global trade.

In international trade, economies with trade surpluses would collect Gold as payment for their exports, while nations with trade deficits would have lower Gold reserves, as it was used as payment for their imports.

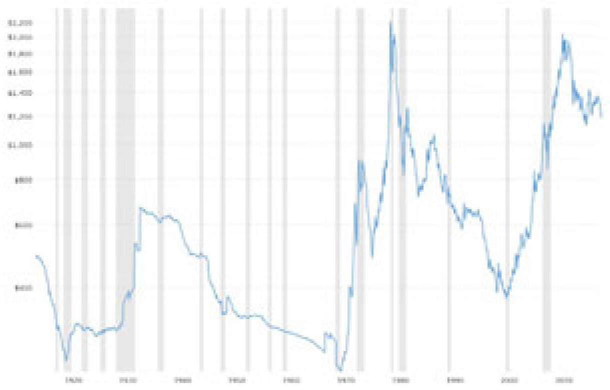
However, linking the value of all trade back to a few lumps of metal, more of which could be dug up out of the ground, had its issues.

Creation of the Gold Standard

To better control the volatility of this method of payment and benefit from a low inflationary environment, the Gold standard was created to guarantee the value of currency conversion into a specific amount of Gold.

This meant that most major currencies would be backed by Gold – it was the Government's job to keep enough Gold in its reserves to back up the amount of currency in circulation.

Check out this 100+ year gold price chart to see how volatile gold can be (Source: MacroTrends).



100+ year gold price chart

As most developed economies at the time pegged their currencies to an ounce of Gold, governments needed to possess a large Gold reserve to be able to meet the theoretical demand for currency exchanges.

Back then, an exchange rate would then be represented by the price difference of an ounce of Gold between one currency and another – this was the first official kind of currency exchange.

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The falling Gold Standard

The Gold standard started to break down during World War I, as many nations decided to print money to be able to finance their huge military expenses. As a consequence, the amount of Gold that these governments had wasn't enough to keep up with the pace at which they were printing money.

The Gold standard worked pretty well through good times, it was weak during bad times

While the Gold standard worked pretty well through good times, it was weak during bad times, creating a lack of confidence in the system, which only worsened worldwide economic difficulties, such as higher international indebtedness, and poorer government finances. Nations around the world needed a more flexible monetary system, so they started to abandon the Gold standard system.

Between the two World Wars

Gold parities were kept and the metal was always the ultimate form of monetary value, but major currencies – particularly those issued from the World War I victors, the United States, France, and Britain – would be used as an international method of payment (and a reserve instrument).

Gold was – and is still – considered as a safe haven asset that nations and investors buy when they seek stability.

From 1920, the American economy boomed during the period known as the "Roaring Twenties", leading to very high inflation and a rapid growth in equity prices that led the American Central Bank (the Fed) to raise interest rates in 1928, and again in 1929.

Graph of the 'Great Depression'

The economic downturn that followed was called the "Great Depression" lasting from 1929 – after the stock market crash of October 1929, to 1939. It was a period of lower consumer spending and investment, which led to high unemployment and slow economic growth.

As interest rates and monetary policies were linked by the international Gold standard, and as countries weren't able to increase their money supplies to stimulate their economies, recessions occurred in many countries around the world and it was very hard for governments to get out of them. Some historians are of the opinion the economic malaise was a big contributing factor towards World War II.

Bretton Woods, a new framework for the currency markets

In July 1944, while World War II was still raging, more than 700 representatives from the 44 Allied nations met in Bretton Woods, New Hampshire, USA, for the United Nations Monetary and Financial Conference.

The major change with the Bretton Woods system was the role of the U.S. Dollar, as it became the World's reserve currency. Indeed, all foreign currencies were pegged to the American Dollar, whose value was itself linked to the price of Gold. These leading Western nations developed the Bretton Woods Agreement.

This new framework had key features such as the use of a system of fixed exchange rates between countries, as well as the creation of 3 international agencies to oversee economic activity.

Did you know

These agencies, formed as a result of the Bretton Woods agreement, are still running in evolved forms today:

- The International Monetary Fund (IMF)
- The International Bank for Reconstruction and Development – now part of the World Bank
- The General Agreement on Tariffs and Trade (GATT) – which led to the World Trade Organization (WTO)

The end of Bretton Woods...

While the U.S. Dollar became the only currency to be backed by Gold, the Bretton Woods system eventually failed. Gold reserves were too low for the American government to provide convertibility for all the US Dollars that central banks held around the world.

Indeed, by 1971, the USA was holding enough Gold to cover only about 20% of foreign American Dollar reserves – not to mention its huge reserve deficit, and the country's growing public debt.

As the Bretton Woods system became untenable, very high inflation led many countries to devalue their currencies, such as France, the UK, and Germany. On August 15, U.S. President Richard Nixon decided to withdraw the U.S. Dollar/Gold convertibility.

...and the beginning of the free-floating system

This action, known as the "Nixon shock" triggered the age of the free-floating currency market, where countries could choose their exchange rate regimes (Jamaica Accords of 1976).

Broad adoption of fiat money replaced the Gold Standard. Fiat money is not ultimately backed by anything physical, like Gold or Sterling Silver, instead, it is backed by the Government issuing it.

However, even though the Gold standard was permanently abandoned and fiat money was adopted, it didn't mean countries would adopt a merely free-floating exchange rate method.

There are 3 exchange rate systems today

Floating rates – where a currency exchange rate freely fluctuates depending on supply and demand. Central banks can also intervene to control extreme fluctuation by raising short-term interest rates, increasing bank reserve requirements, and buying/selling their own currency to control pricing.

Pegged rates – where one country directly links its currency exchange rate to another currency, such as China's Yuan, and the Hong Kong Dollar that are linked to the U.S. Dollar, or Bulgarian Lev, and Denmark's Krone are pegged to the Euro.

Dollarisation – where a country uses a foreign currency as its national currency, such as Panama, and El Salvador, which use the American Dollar.

The internet age

In the past, the main participants in the Forex market were only central banks, commercial banks, highly wealthy investment funds, and large international financial institutions.

However, the development of technologies have led to the creation of internet-based trading platforms for individual traders, also called retail traders, allowing them to trade in smaller sizes than what's offered on the interbank market and using margin.

Forex trading platforms are now provided by Forex brokers – these could either be market makers, creating their own bid and ask prices, or Electronic Communications Networks (ECN), using available prices from the interbank market.

Cryptocurrencies

In 2008 Bitcoin was launched, bringing with it the Age of cryptocurrencies – the next step in the evolution of currencies. Bitcoin is a digital currency, meaning it is decentralised – without a Central Bank backing or administering it. The 'I promise to pay the bearer' commitment is now not from the Chief Cashier backed by a Government's wealth but instead is a concept digitally enforced through cryptology.

The number of Bitcoin is fixed at 21 million meaning, eventually, only demand will influence its price.

digital currency is free from supply manipulation by central banks

All cryptocurrencies have a distributed ledger of transactions called a blockchain verified on nodes using a sophisticated encryption process. The theory is this level of protection means the digital currency is free from supply manipulation by Central Banks. The end of 2017 saw Bitcoin surge in value – as everyone clambered to be part of something new – before falling back.

There are now hundreds of cryptocurrencies and the concept is in its infancy – while digital currencies have clear advantages over fiat currencies, there are clear disadvantages as well – the jury is definitely out as to its place in the currency landscape but it is certainly here to stay in some form.

Chapter 6 – Spot Forex, CFD or Spread Bet

The Foreign Exchange markets are the most traded global markets in the world, attracting more and more retail customers, who hope to take advantage of changes in currency pair prices.

Forex traders access the markets through financial products. Spot Forex, CFDs, and Spread Bets are the three main products traders use to access markets with. For example, a trader can trade the EUR/USD market with a CFD product.

The three products are similar as they all offer similar levels of margin and can be used to access nearly all currencies pairs, but they have a few differences that we will explain below.

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Spot Forex

Throughout this guide, by default, we've been discussing spot Forex – the name of the market and product are used interchangeably. This is simply the trader buying one currency and selling the other – 2 days later the currencies settle into their accounts.

Spot vs cash Forex

You'll hear the terms cash and spot Forex used regularly. They are very similar but there is a small difference. Cash Forex is the rate right now, spot Forex is the rate for delivery in 2 days. The latter factors in the cost of financing the respective currencies for 2 days. Forex traders will nearly always be trading the spot market's price.

Traders will do this through their Forex broker. As part of its service, all Forex brokers will provide the trader with leverage – this means it will only require the trader to fund a small percentage of the currency positions taken on in their trading account – this is called margin. We'll explain margin trading in detail in the next chapter so we won't dwell on that here.

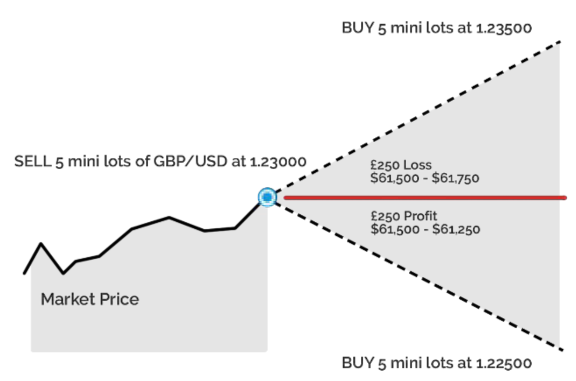
We've taken you through the basics terms and concepts of spot Forex earlier in the guide – lots, pips, pip value, etc – so we won't repeat them here, rather we'll take you through a trade to highlight the differences of each product.

Example: spot Forex trade

Let's talk you through the process of a trader shorting 5 mini lots of the GBP/USD pair. If the market price was 1.23000 when the trade is struck the trader is selling £50,000 and buying $61,500.

If the price moves 50 pips down to 1.22500 then the dollar has appreciated against sterling. The trader can buy back the £50,000 using just $61,250, leaving a $250 profit.

Alternatively, if the market price moved against them and dollar depreciated by 50 pips to 1.23500 when they came to buying back the £50,000 it would then cost $61,750, a loss of $250.



Spot Forex trade example

The distinguishing feature of trading spot Forex, compared to the other two product types we're about to introduce you to, is it is not a derivative. The trader is trading the underlying asset – the two currencies need to settle 2 days after the transaction (the broker will do this for you). What this means is there does not need to be two legs of the trade (we did in our GBP/USD example). For instance, our trader going short £50,000 can cover this by buying £50,000 using another, better priced, currency pair.

The other reason to trade using spot Forex, and not the other products, is one of scale. Big volume traders, we're talking hedge funds here and not private traders, like to transact in the underlying market. That way they know the price they got was 'on market' and not impacted by the size of trade relative to the provider of the derivative product. Retail derivative brokers are set up to cater for flow business (lots of small trades) and not large lumpy transactions.

Spot Forex pros:

- ✓ Permitted in a lot more countries than CFDs or spread bets.
- ✓ Traders are dealing in the underlying cash market so there can't even be the risk of slippage in price between the underlying and the derivative markets (CFDs, spread bets).
- ✓ Very liquid markets traded nearly 24 hours a day.
- ✓ A much wider range of brokers offer spot Forex.
- ✓ Losses are likely to be tax-deductible.

Spot Forex cons:

- ✗ Traders can only trade currency markets through spot Forex.
- ✗ Profits are likely to be taxable.

Contracts for difference

Contracts for Difference (CFDs) represent a financial contract between a trader and their broker to exchange the difference between the opening price and the closing price of an asset. No underlying assets, in our case currencies, are exchanged. It is simply an agreement to exchange the difference in price.

The real benefit traders get from trading CFDs is they can trade the price of pretty much anything with a verifiable price – shares, indices, commodities, profit and definitely the currency markets – all from one trading account.

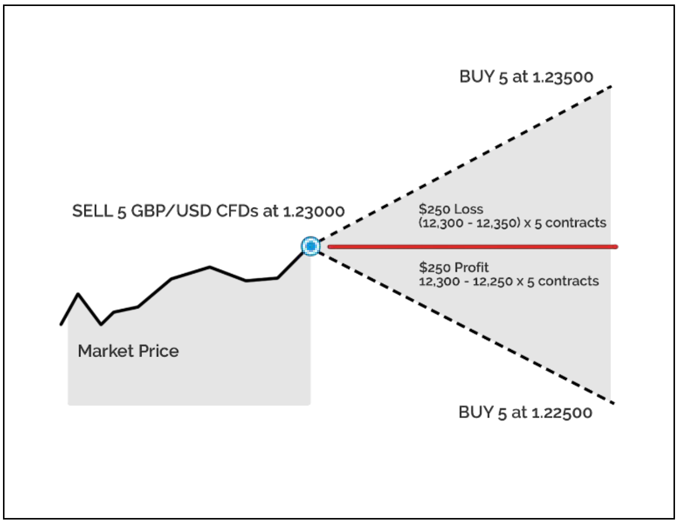
Example CFD trade

Let's show you a similar short GBP/USD trade but this time using a CFD, instead of spot Forex. For an FX CFD the P&L is always in the quote currency (2nd currency) of the pair, so for a GBP/USD CFD trade, this is USD.

It is really important to check the size of the CFD contract the first time you trade with a broker – in this example, it is for 10,000 of the base currency (some broker's CFDs are 100,000).

1 FX CFD contract is per 0.0001, so in our example below 1 contract gets you $12,300 of exposure.

By opening the trade and going short GBP/USD the trader is speculating USD will appreciate against GBP (or GBP depreciates against USD, its the same thing). To close the trade the trader must buy back the 5 CFD contracts.



The trader has to put up a similar amount of margin. Because no underlying currencies are exchanged they must buy back the 5 contracts to close the trade.

CFD pros:

- No stamp duty on share CFDs.
- A huge range of markets can be traded using them, the popular CFDs are for equities, fx, commodities and debt markets.
- Low transaction costs – much cheaper than buying or short selling (borrowing, selling and buying back later) an underlying asset.
- Traders do not have to take delivery of the physical asset – like barrels of oil.
- A CFD is traded over the counter – this means it is not traded via a central exchange, it is an agreement between two parties. This allows brokers to be innovative and flexible in the markets they offer traders. Cryptocurrency CFDs are the most recent example of this flexibility.
- Losses are likely to be tax-deductible (your tax status is unique to you, we are not tax advisors so please get some advice if you need it).

CFD Cons:

- CFDs can exposure the trader to currency risk, even when they aren't trading currencies.
- Leverage is hard-wired into the product. New traders sometimes don't appreciate the underlying exposure they are taking on.
- Traders do not own the underlying asset and therefore don't have any of the direct ownership rights you'd normally expect – like voting rights on company shares.
- Profits are likely to be taxable (your tax status is unique to you, we are not tax advisors so please get some advice if you need it).
- Banned or limited in some countries because of concerns over leverage, among other things.

Spread betting on currencies

In broad terms, a financial spread bet is a CFD wrapped up as a bet for tax reasons. With financial spread betting in the UK and Ireland, any profits are normally tax-free.

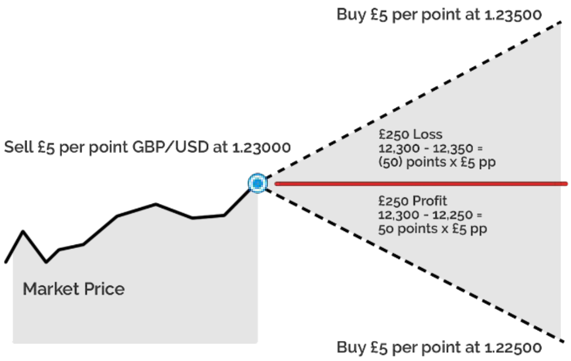
Traders specify an amount per point they want to bet on the price of an underlying asset

There are some differences. Instead of trading contracts, traders specify an amount per point they want to bet on the price of an underlying asset. This is done in the account's base currency, so the currency risk CFDs bring is now gone – traders set their base currency when they open the account. Every time the price of the selected currency pair moves in your direction, you will gain your stake times the number of points by which the pair has moved in your favour, and vice-versa.

Like with CFDs, a spread bet is an OTC derivative and the trader does not own the underlying asset. In order to trade, the broker needs the trader to place margin on the account, not requiring the trader to fully fund the value of the underlying asset being bet on creates leverage.

Example CFD trade

For the GBP/USD spread bet a point is set at 0.0001, so from 1.230**00** to 1.1230**10** is a 1 point move, so again the same as a pip. The trader has set the base currency of pounds so will sell GBP/USD at £5 per point – if it was set at Euros they could sell €5 per point, Australian dollars at A$5 per point and so on.



Note the base currency is £, so the betting per point is in £ and therefore so is the P&L. The exposure to USD at the start of this example was £12,300, please note the difference to the CFD, where it was $12.300.

Spread betting pros:

- No stamp duty on company share spread bets.
- No capital gains tax in the UK and Ireland on profits.
- Unlike CFDs, there is no base currency risk.
- A huge range of markets can be traded using them.
- Low transaction costs, like CFDs.
- OTC – so flexible and innovative.

Spread betting cons:

- Losses are likely to not be tax deductible so FSBs are not that useful when hedging.
- Leverage is hard-wired into the product. New traders sometimes don't appreciate the underlying exposure they are taking on.
- Traders do not own the underlying asset and therefore don't have any of the direct ownership rights you'd normally expect – like voting rights on company shares.
- Banned or limited in some countries because it's legally a CFD. Its also banned or limited in other countries because it's a bet.

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Which product to use?

By now you should appreciate how similar these products are: similar range of currency pairs available, similar leverage and a similar exposure to the underlying price movements. So, how do retail traders choose?

Legality

Sometimes it is that CFDs and spread bets are just not available through a broker regulated in your jurisdiction or its illegal for an overseas broker to offer the products into your country. Nowadays, in countries like the US, both products are illegal.

Consequently, traders have to turn to spot Forex trading if they want to exchange currencies. Here is a full breakdown of the legality of CFDs around the world.

Tax treatment

A major factor that could influence your choice of product are the taxes applied to each financial instrument.

Spot Forex trading has similar rules to the taxes applied with CFD trading, meaning that you'll typically pay Capital Gains Tax on profits, and your losses are deductible.

On the other hand, spread betting activities are normally tax-free in the U.K. and Ireland, as you do not have to pay capital gains tax. Moreover, spot Forex trading, CFDs, and spread bets do not incur any stamp duty.

Currency risk

With spot FX trading, profit and losses (P&L) are denominated in the quote currency. As there is a real exchange of currencies, the trader's account will have different balances with the various currencies they traded.

With CFDs, the P&L is denominated in the contract's currency, while with spread bets, you bet in the base currency of your account, meaning that your main concern is whether or not the currency pair will finish higher than the opening price.

Other markets

If you trade on more than just currency markets – like shares, or indices, or commodities – and don't want to manage multiple accounts then CFDs and spread bets offer this opportunity.

Direct market access

When trading directly on the spot Forex market traders know they are exchanging the underlying currencies and getting the prices as they are in the market. This tends to favour very short term scalpers and very big traders. The benefits, protections and auxiliary services offered by retail brokers often outweigh these reasons for retail traders.

A final thought on products

Everyone's circumstances are different so what might work for you won't for someone else. The important thing is to know what products are available so you can make an informed decision. Don't just go for the first product or broker you come across, get clear on the type of product you want to use to trade the currency markets with and find the best broker for it.

Chapter 7 – How Margin Trading Works

Retail traders are increasingly attracted to the Forex markets because trading currencies has become increasingly accessible – available 24 hours a day, 5 days a week with potentially a low level of capital.

However, some concepts are still unclear to many new traders who wish to succeed in currency trading – even though a margin account may be opened, many traders aren't able to provide a clear definition of margin trading, or leverage.

Yet both concepts are essential to fully understand how to profitably trade the foreign exchange market.

Let's begin …

A word of caution

Trading on margin with high leverage isn't for every kind of trader.
It is more suitable for short-term trading styles such as scalping, or day trading because these styles are seeking to extract profits from tiny price movements. The leverage then increases these profits.

When using leverage traders pay to fund the amount effectively borrowed. These funding costs increase over time and need to be taken into account when calculating profits and losses. The longer a trader keeps a rolling position open with margin trading, the higher the funding costs will be.

Learn more: Take our free Margin Trading Demystified & Margin Trading Products course

What is margin trading?

Unlike cash accounts, margin accounts allow you to use borrowed money to open and hold financial positions.

Leverage	Amount Traded	Required Margin
1:1	$100,000	$100,000
2:1	$100,000	$50,000
50:1	$100,000	$2,000
100:1	$100,000	$1,000
200:1	$100,000	$500
400:1	$100,000	$250

Note: Actual Required Margin would change per currency pair.

Margin trading allows you to obtain a greater exposure to the asset than you would if you used your capital to trade the asset for cash.

For each position you want to open, there is a margin requirement associated, which is the amount of money you need to put aside, as collateral, or security deposit with your broker.

Did you know

Margins are usually expressed as a percentage of the total amount of your trading position. For example, Forex brokers may require a 5% margin.

Leverage is a by-product of margin

By only putting up a small percentage of a position as margin, it creates leverage or as some call it, gearing.

Leverage and margin are linked

If your broker has a margin requirement of:

- 5%, then your leverage will be 20:1
- 3%, then your leverage will be 33:1
- 2%, then your leverage will be 50:1
- 1%, then your leverage will be 100:1
- 0.5%, then your leverage will be 200:1

Let's say that you're able to put aside a $3,000 margin – this is your trading capital. Your broker offered you 30:1 leverage. This means that you can initially trade a maximum of $90,000 ($3,000 x 30) in trading positions. Of course, this amount will fluctuate depending on your profits or losses – not to mention commissions, interest and other fees.

If you want to trade a "lot" on the EUR/USD, which equates to €100,000, and your broker is asking for a 3.33% margin, this means that you only need to deposit €3,333 into your trading account, and the other 96.67% will be effectively loaned by your broker.

Key margin trading terms

There are some terms you'll see in your trading platform that you need to know about, such as initial margin, maintenance margin, margin calls, and negative balance protection, among others.

Initial margin

The initial margin, sometimes called the deposit margin, is the minimum amount that will be required from you to open a trading position.

Because this margin is only a small part of the full value of your position, this amount might not be enough to cover your losses if the market turns against you. You'll then need to monitor your maintenance margin.

Maintenance margin

The maintenance margin is supposed to ensure that you will have enough capital to keep your positions open, as it should cover any running losses. It represents the minimum balance that you should maintain in your account.

Margin call

If your trading position moves against you, and your current capital cannot cover your margin requirement, then you will receive a margin call from your broker.

This occurs when the equity of your account falls below your broker's margin requirements. At that point, your broker may require a deposit of a certain amount of money in your trading account. If you don't stump up the extra margin then the broker will close out your positions.

Negative balance protection

Sometimes, stop-loss orders, or margin calls, aren't enough for traders to avoid excessive losses. This happens when the market isn't liquid, or when there are very fast-paced, volatile price movements, with gaps and slippage.

For example: a financial earthquake in Switzerland

On January 15th, 2015, the Swiss National Bank (SNB) decided to stop the minimum exchange rate of CHF 1.20 per Euro, and created a flash crash on the Swiss Franc.

That day, the EUR/CHF currency pair dropped as much as 40% in just a few minutes, forcing FXCM's clients to sustain more than USD 225 million in negative balances.

Many brokers offer negative balance protection – all EU regulated brokers must offer this as mandatory – which provides a safeguard to traders in times of higher volatility and trading volume, so retail traders don't face a negative balance and owe more than they deposited.

Risk of margin trading

Borrowing money to trade in a volatile market is risky, as prices can change rapidly, and there is a possibility that the market moves against you, which will, in turn, increase your losses.

More than that, markets can move so quickly that it's possible for you to lose more money than your initial deposit, as your balance can turn negative after margin calls.

You will then owe money to your broker if it doesn't offer negative balance protection. If you can't meet the margin call, your losing positions will be closed, forcing you into liquidation.

Keep an eye on your broker's policies about margin requirements and leverage

Keep an eye on your broker's policies about margin requirements and leverage, as depending on the currency, or the inherent economical or geopolitical risks, these policies can affect your trading.

Remember: Trading on margin amplifies your profits AND your losses, which means that you need to follow money and risk management rules to avoid wiping out your trading account.

So, is margin trading good or bad?

Well, margin trading is an incredible opportunity offered by brokers to trade large amounts of an asset in the financial markets with a small initial investment. Of course, this isn't without any risks, but if managed well, you can amplify your profits while trading currencies.

For leverage to work in your favour as a trader you need to be profitable overall – if you are, leverage will enhance your profits, if you're loss-making then leverage enhances losses. Taking the time to learn the skills needed to trade becomes even more important.

Learn more: Take our premium Trading for Beginners course

Chapter 8 – Best time of day to trade

Knowing the best times of the day to trade on the Forex markets can be crucial to your trading success.

While this is especially true for scalpers and day traders, even swing traders can benefit a lot by executing trades during the most liquid time of day.

Lower transaction costs, larger than average price fluctuations and more trading opportunities are all closely related to the time you execute your trades.

In this chapter, we'll cover the best time of day to trade Forex and explain its main benefits to your trading performance.

How does your trading style impact your entries?

Your trading style has a major influence on when you trade the Forex markets. As a general rule of thumb, shorter-term trading styles call for more precise timing of market entries than longer-term trading styles.

...getting the timing right can make or break your trading day

This means scalpers and day traders need to pay special attention to the time of day they trade, as less-liquid trading sessions may carry higher transaction costs and eat into their potential profits.

If you open plenty of trades during the day, getting the timing right can make or break your trading day.

Swing and position traders are less affected by the time of day they place their trades, since their overall profit-target and trading horizon is much larger compared to that of scalpers and day traders.

Major forex trading sessions

To determine the best time of day to place trades on the Forex market, you need to be aware of how the market operates.

Forex is an over-the-counter market.. Unlike the stock market where stocks are traded on stock exchanges, there is no one centralised exchange in Forex.

Instead, currencies are bought and sold in major financial centres around the world, called Forex trading sessions.

The most important of them is the New York, London, Sydney and Tokyo sessions, which span over different time zones, making the Forex market active 24 hours a day, 5 days a week.

Generally, if you're looking to trade Asian currencies and cross-pairs that involve the Australian dollar, New Zealand dollar or Japanese yen, you could do so during Asian trading sessions (Sydney and Tokyo).

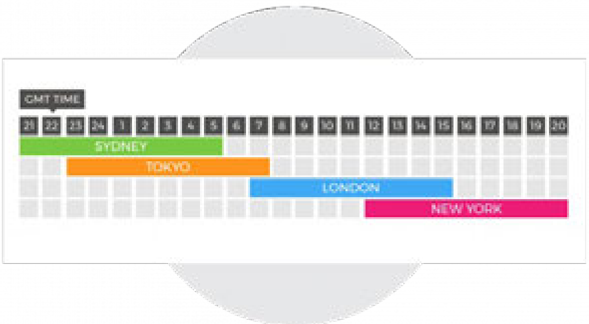
Besides the US dollar which is heavily traded during all sessions, Asian currencies have the largest turnover when the Asian markets are open. This means larger price fluctuations and lower spreads on trades that involve Asian currencies, which is a major advantage for day traders and scalpers.

Time Zone	EDT (April – October)	EST (October – April)	GMT
Sydney Open	6:00 PM	4:00 PM	10:00 PM
Sydney Close	3:00 AM	1:00 AM	7:00 AM
Tokyo Open	7:00 PM	6:00 PM	11:00 PM
Tokyo Close	4:00 AM	3:00 AM	8:00 AM
London Open	3:00 AM	3:00 AM	7:00 AM
London Close	12:00 PM	12:00 PM	4:00 PM
New York Open	8:00 AM	8:00 AM	12:00 PM
New York Close	5:00 PM	5:00 PM	9:00 PM

Major Forex trading sessions

The London-New York overlap – the best time to trade forex

The Forex market has a daily turnover of around $5 trillion, and the London and New York sessions still account for the majority of that turnover.



The London-New York overlap

The US dollar is still the most-actively traded currency in the market, involved in nearly 88% of all Forex transactions, and all-important news releases related to the US dollar are published with the opening of the New York session.

The London session, on the other hand, still remains the session with the largest daily turnover, covering around 37% of all Forex transactions initiated during a day.

The London-New York overlap, which is the time of day when the two largest Forex trading sessions are both open, traders get the largest price swings and lowest spreads to trade the market.

The London-New York overlap starts at 12:00 PM GMT and closes at 4:00 PM GMT, Monday through Friday.

It's over the Atlantic

For day traders and scalpers, the best time of day to trade Forex is the London-New York overlap, which ensures the tightest spreads and largest price swings. Additionally, major Forex news is reported at the beginning of the New York session which can have a large impact on the rest of the trading day.

Unless you use a fixed spread broker spreads – the difference between the bid and ask prices – constantly change during the day. Avoid opening positions outside the main trading sessions, as liquidity in the market may still be low and spreads high.

Chapter 9 – Forex Regulation and Protection

So, you want to get into Forex trading? Before you open a Forex trading account and fund it, check the regulatory status of your broker to find out if and where it is licensed and authorised. Regulation is a very important part of trading.

As we have already established, Forex is an OTC and not an exchange-traded market. This provides lots of benefits but by not having a central exchange it potentially removes some of the oversight needed for the market to be fair and not abused.

This is where regulators come in – OTC markets, especially retail OTC markets, need good regulation to police it. The regulator needs to strike a balance between letting the free market trade and protecting the small guy from unfair practices.

In any case, you need to work with a trustworthy, well-regulated Forex broker that looks after your money, has fair market practices, doesn't mislead you in its marketing and has enough capital to stand behind its commitments to you.

Usually, brokers display on their websites by whom it is regulated, and a risk warning that should be standardised within all European countries according to new ESMA rules.

Learn more: Take our free Understanding Brokers course

Client classification

In developed Financial industries, there are different rules for different types of participant. In the UK anyone participating in financial services is classified as one of the following:

- **Eligible counterparties** – these are institutions that really understand the risks they are taking on. These would be banks, big hedge funds, big investment managers, governments, central banks – those sorts of participants.
- **Professional clients** – these are businesses or individuals that are not huge institutions or experts. However, they are experienced in what they are doing and understand the risks. Sophisticated private traders, with significant resources, would fall into this category.
- **Retail clients** – this is everyone else that isn't an eligible counterparty or a professional client. Most private traders fall into this category.

The reason for the categorisation is different financial regulations are applied to different categories of client. Protections for retail traders are a lot greater than for professional traders, which in turn are greater than those for eligible counterparties.

Unless you are very experienced and have significant resources, you will be a retail trader by default – this means you'll be afforded the highest levels of protection on offer, but also accept some limitations on the products and services you can use.

Retail vs professional Forex traders

These classifications mainly impact Forex traders trading with a UK regulated broker in the following ways:

	Retail	Professional
Leverage	Capped	Uncapped
Incentives	No	Yes
Complex products	No	Yes
Negative balance protection	Yes	No
Segregated client funds	Yes	No
Access to Financial Ombudsman	Yes	No
Access to FSCS	Yes	No

Classifications affecting UK Forex traders

Who regulates the Forex market?

All countries differ in their approach to regulating Forex trading. There is no global agency overseeing the global Foreign Exchange market, there are national authorities that regulate that country's Financial Services sector, such as:

- Autorité des Marchés Financiers (AMF) in France
- Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) in Germany
- Comisión Nacional de Mercado de Valores (CNMV) in Spain
- Financial Conduct Authority (FCA) in the U.K
- European Securities and Markets Authority (ESMA) for the European Union
- U.S. Securities and Exchange Commission (SEC) in the U.S.A
- Australian Securities Investments Commission (ASIC) in Australia

In 2015, the Foreign Exchange Working Group (FXWG) was created to work on global principles of good practises for the FX markets, which led to the May 2017 publication of a global code of conduct for wholesale foreign exchange markets.

The Bank of England belongs to the 16 member institutions that signed up to FX Global Code and helped to work on a further harmonised Forex industry, and better global protection of retail consumers trading the Forex market.

Forex regulation in the UK and Europe

According to the BIS Triennial Central Bank Survey 2016, London is the most important sale desk in the world. The United Kingdom gathered 36.9% of the global OTC Foreign Exchange turnover between April 2013 and April 2016.

In the U.K., there are 2 main financial regulatory bodies:

Financial Conduct Authority
The FCA, which describes itself as "the conduct regulator for 58,000 financial services firms and financial markets in the U.K.", helping to protect consumers.

Prudential Regulation Authority
The PRA, which belongs to the Bank of England (BoE) works at ensuring the health and safety of the 1,700 financial firms that it is responsible for.

These two primary institutions also work with different bodies, such as:

- The Financial Ombudsman Service
- The Money Advice Service
- Payment System Regulator
- The Serious Fraud Office
- And the Financial Services Compensation Scheme among others

European Securities and Markets Authority

Due in part to the increasing use of leverage by retail traders and aggressive marketing practices in the EU by brokers, in 2018 ESMA decided to intervene to prohibit binary options and restrict the use of Contracts for Difference (CFDs), these changes extended to rolling spot Forex and financial spread bets.

ESMA rules

These rules impacted Retail Forex traders (not professional clients) as follows:

- Limiting the leverage used by retail traders to 30:1 for major currency pairs, 20:1 for non-major currency pairs, and 2:1 for cryptocurrencies.
- Automatically applying a 50% margin close out rule on a per-account basis.
- Negative balance protection on an account was made mandatory.
- And prohibiting all monetary/non-monetary benefits offered – this meant account opening bonuses were banned.

ESMA oversees all Financial Services business in Europe, and most country regulators, like the FCA, adopted the measures.

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Forex regulation in the USA

After the United Kingdom, the United States is the 2nd most important sales desk, with 19.5% of the global OTC Foreign Exchange turnover between April 2013 and April 2016. CFDs and spread bets are banned for retail traders in the US, so spot Forex is very popular and tightly regulated.

There are 2 main obligatory regulating organisations for Forex brokers in the USA:

- The **National Futures Association** (NFA), whose main goals are to protect investors from scams and fraud, to preserve the integrity of the derivatives markets, and to ensure that its members respect their regulatory responsibilities, and
- The **Commodity Futures Trading Commission** (CFTC), that works at avoiding systemic risk, and helping traders to determine if the Forex firms they want to use are reliable.

Forex leverage caps in the US

These rules impacted Retail Forex traders (not professional clients) as follows:

- 1:50 for major currency pairs
- And 1:20 for all other pairs

There is also the Foreign Exchange Committee (FXC), sponsored by the Federal Reserve Bank of New York. They have been working on guidance to Foreign currency trading since 1978.

How this impacts you

The regulator's job is to regulate the brokers, it is not there to tell the citizens of that country where they can trade, that is the individual's decision.

For time immemorial it was assumed the citizens of a particular country would naturally choose to use a broker from that country – then came the internet which allows traders to use brokers from other jurisdictions.

The regulatory environment is still adapting to this seismic shift in how business is done.

Each trader will have their own requirements, so it is important each trader does their own research around the risks and benefits of a particular jurisdiction or broker.

If the capped leverage is not a concern, then EU traders tend to gravitate towards an FCA broker.

Outside the EU, and the US, traders either trade with a broker in their own jurisdiction, or if that is less developed, gravitate towards an ASIC regulated broker.

It is an important decision, so don't click on the first shiny banner advert promising 1000x leverage, take your time and place regulatory protections at the top of the criteria you use to choose your broker.

There is no one size fits all – what might be great for a new trader might not work for an experienced trader. The good news is it is a big competitive industry with lots of brokers to choose from.

Chapter 10 – AUD/NZD Spot Forex Trade

To show you how Forex trading works, in this chapter we will take you through a spot Forex trade on AUD/NZD.

This is the first example of three, we will take you through a worked example of a trade using spot Forex, a CFDs, and a spread bet.

For the sake of the example, we'll assume our trader wants to go long AUD/NZD. This means they think Australian Dollars will appreciate against the New Zealand Dollar.

How they came to that view isn't relevant for this chapter – but we hope it came from good analysis and was part of a thought-out trading plan.

A reminder

- In a currency pair, the first currency in the pair – the one on the left – is the base currency.

  The second currency – the one on the right – represents the quote currency.

- In Forex trading, you're always exchanging two currencies. If you think the base currency will strengthen against the quote currency, you would buy the currency pair.

  Conversely, if you believe the base currency will weaken against the quote currency, you would sell the currency pair.

- In a quote from your broker, the bid price – also known as the sell price – is where you can short the pair, while the ask price – the buy price – is where you can go long the pair.

- Spot Forex is traded in lots. Lots are equivalent to 100,000 units of the base currency. Mini-lots are 10,000 units, micro-lots 1,000 units, and nano-lots are 100 units.

For the sake of this example we've assumed the trader is based in the UK, they have chosen to trade with an FCA regulated broker and the currency they fund their account with is Pounds Sterling.

Going long AUD/NZD with a spot Forex trade

Our trader opens up their broker's trading platform and locates the AUD/NZD currency pair and opens up a deal ticket. The base currency is AUD and quote is NZD, so this means 1 Australian Dollar is worth approximately 1.07 New Zealand Dollars.

AUD – NZD spot Forex trade

We are trading spot Forex and our trader wants to trade a standard lot. This is entered into the deal ticket as a volume of 1.00 – this means we are looking at an underlying trade size of A$100,000.

A pip in spot Forex is every 0.0001 in price, so a one pip move has a value of NZ$10.

We can see a quote of 1.07017 – 1.07035. Given our trader wants to go long the pair they must buy at 1.07035.

As well as the spread (in this case 1.8 pips), spot Forex attracts a small commission charge, this will be advertised by the broker on their website. In our case, the trader has a £ account so will pay a commission of £1.25 per lot per leg, so to enter and exit this trade a 'round trip' commission will be levied of £2.50. Commission charges vary by broker.

What is the margin

The trader's account balance is in £, but they will need the equivalent of approx. A$5,000 to act as margin for this trade.

AUD/NZD is a minor fx pair and FCA regulated brokers are required to cap leverage at 20:1 on it. This might vary based on where your broker is regulated.

The size of the trade is A$100,000, so dividing by the leverage of 20 gives us A$5,000.

Because the trading account is in £, our trader checks the GBP/AUD rate and it is near enough 1.81. This means they'll need approximately £2,762 in their trading account to put the trade on. If the GBP/AUD exchange rate changes the amount needed in £ will also change. However, our trader has £50,000 trading capital so this margin is comfortably covered and any small variations will be marginal.

Although we consider it bad risk management, for the sake of this example, our trader does not set stop-loss or limit orders when entering the trade. We'll show you these when we get to our spread bet example.

Our trader is comfortable with the price and enters the market order by clicking 'Buy by Market'. This is a request to the broker to place a trade at the market rate so it could get filled at a slightly different price. However, we're trading at a liquid time of the day without much volatility so this fills at the price on the ticket and is confirmed immediately – **Buy 1 lot AUD/NZD at 1.07035**.

What our trader has done is to buy A$100,000 and sell NZ$107,035. The platform shows them their positions, excluding the sterling account balance:

Asset	Volume
AUD	100 000
NZD	-107 035

Our trader is a swing trader so plans to hold the trade for about a week. Every night the trade is held – 10pm London time – they will incur a 'swaps' charge, on this particular trade the charge is A$7.60 per night.

Why are traders charged overnight funding?

Overnight funding includes two fees. Calculated on a daily basis the swaps fee is normally different for each currency pair, it is the interest rate differential on the two currencies.

Traders receive interest on their long positions and pay it on their short positions, when netted off this is called the Tom-next rate. Brokers also charge a rollover fee – this is to roll a position priced using that day's spot rate into the next day. With interest rates so low at the moment, the majority of the charge is the broker's rollover fee, give or take this is about 2.5% on an annualised basis.

Outcome: losing trade

The appreciation of the Australian Dollar has not materialised as the trader had hoped. In fact, the New Zealand Dollar has appreciated a little. The trader decides to cut their losses and exit the trade.

The price is quoted 1.06631 – 1.06649. Because they are long the pair, to exit they will sell 1 lot at the bid price of 1.06631. This is confirmed by the broker and they are out.

1.06631 / 1.06649

They lost 40.4 pips on the trade:

1.06631 – 1.07035 / 0.0001 = **-40.4 pips**

We know the value of trade was NZ$10 per pip, so a loss of NZ$404. The broker will convert this loss back into the account currency of £, a £209 trading loss.

What they have done here is to sell A$100,000 to buy NZ$106,631. The NZ$404 trading loss is the extra they had to make up to make good the NZ$107,035 sold in the opening trade.

The trader held the trade open for 6 nights, so has an overnight funding charge of A$7.60 x 6 = A$45.60, again this is converted back to £25.10.

Add in the commission of £2.50 and this trade has lost the trader **£236.60** in total.

Spot Forex trade

That is a spot Forex trade, we went into quite a bit of detail, the points to note are:

- The trader lost money on this trade because they went long Australian dollar and it ended up depreciating against the New Zealand dollar.
- They incurred commission and overnight funding costs.
- In practice, most retail spot Forex brokers offer smaller sizes than lots and allow much more granularity on size. When trading using direct market access into a certain liquidity pool, traders have to use the standard sizes.
- The trader's account currency is £, this means they are exposed to several exchange rates when trading two non-GBP currencies.
- There was no stop-loss order set, this was bad risk management, had the price fallen further up it could have created a significant loss.
- The loss would likely be tax-deductible. Had they made a profit it would likely not be capital gains tax-free.

Chapter 11 – GBP/USD CFD Trade

We have shown you a spot Forex trade, so in this chapter, we will take you through a CFD trade on a currency pair.

This is the second worked example of three, where we are taking you through the currency trades using spot Forex, a CFD, and a spread bet.

For the sake of our CFD example, we'll assume our trader wants to go short GBP/USD. This means they think the US Dollar will appreciate against Pound Sterling. How they came to that view isn't relevant for this chapter – but we hope it came from good analysis and was part of a thought-out trading plan.

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A reminder

- A CFD is a contract for difference. When trading a CFD a trader is agreeing to exchange the difference in price between the point the trade is opened to the point it is closed. No underlying currencies are exchanged.
- In a currency pair, the first currency in the pair – the one on the left – is the base currency. The second currency – the one on the right – represents the quote currency.
- In Forex trading, the price you're trading is always to buy one currency and sell the other. If you think the base currency will strengthen against the quote currency, you would buy the currency pair. Conversely, if you believe the base currency will weaken against the quote currency, you would sell the currency pair.
- In a quote from your broker, the bid price – also known as the sell price – is where you can short the pair, while the ask price – the buy price – is where you can go long the pair.
- CFDs are traded in contracts.

For the sake of this example we've assumed the trader is based in the UK, they have chosen to trade with an FCA regulated broker and the currency they fund their account with is Pounds Sterling.

Going short GBP/USD with a CFD

Our trader opens up their trading platform and locates the GBP/USD CFD market. They open up the market information tab just to check over what they are about to trade.

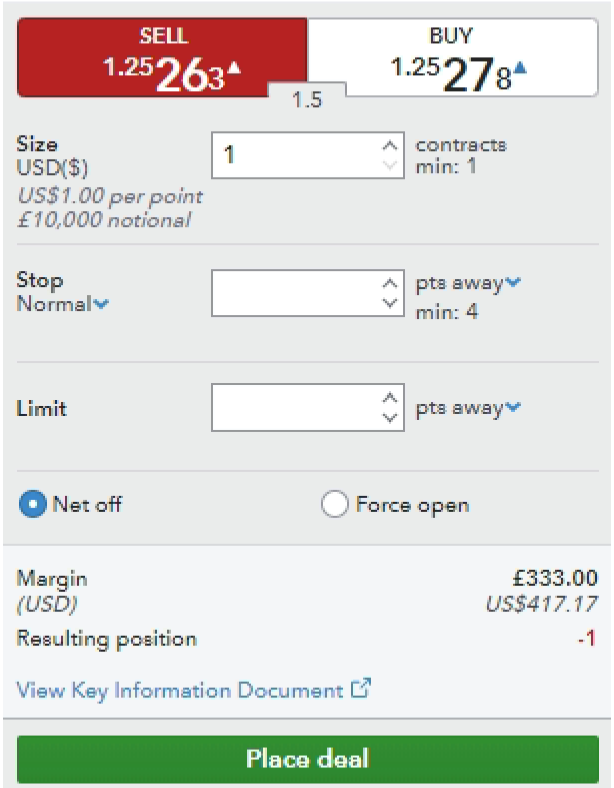
Minimum size	1
Contract size per point	GBP 10,000
One point means	0.0001 USD/GBP
Value of one point	USD 1 (GBP 0.80)

This confirms the contract is 1 CFD, with a notional value of £10,000 (the base currency), a 1 point move in price is 0.0001 – the same as a pip – and given the price is in the quote currency of the pair – USD – the value of one point is $1.

Check contract specification

The first time you trade with a broker it is really important to check the CFD contract specifications you are about to trade because some brokers use a notional value of 100,000.

Next, our trader opens up a deal ticket. The sell price is 1.25263, this is the price they can go short at. The buy price is 1.25278, this is the price they can go long at. This is a spread of 1.5 points.



Open deal ticket

The size is the number of contracts our trader wants to trade – they trade the minimum, which is 1 contract.

How much margin

The trader is trading with an FCA regulated broker so the maximum leverage on the GBP/USD pair is 30:1. So, the margin is calculated as follows:

1 CFD contract = £10,000 / 30 = £333

This is confirmed by the information on the deal ticket.

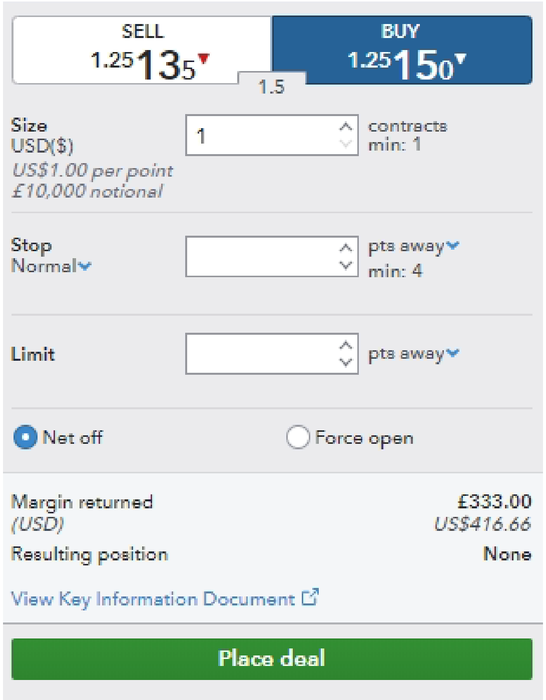
Our trader has £50,000 of trading capital in their account and no other open trading positions so they can fund this position comfortably.

The trader is happy with everything so places the Sell **1 GBP/USD CFD at 1.25263**.

For this example, our trader hasn't set a stop or limit order – it is good risk management practice to always trade with at least a stop-loss order in place, protecting the downside. We'll show you these orders when we take you through the spread bet example in the next chapter.

Outcome – winning trade

Our trader has called it right. The price has gone down so they decide to lock in a profit and exit the trade. They open up the deal ticket and the live quote is 1.25135 – 1.25150. To close the trade, they must buy back the 1 contract, so this is done at the buy price of 1.25150. Buy 1 GBP/USD CFD at 1.25150.



Deal ticket example

The trader now does not have any open positions – they are flat – so the broker releases the margin, plus the profit, back as funds available to trade.

The P&L on the trade was as follows:

We work out the difference in price (it's a contract for difference):

1.25263 – 1.25150 = **0.00113 dollars**

Next, how many points this was

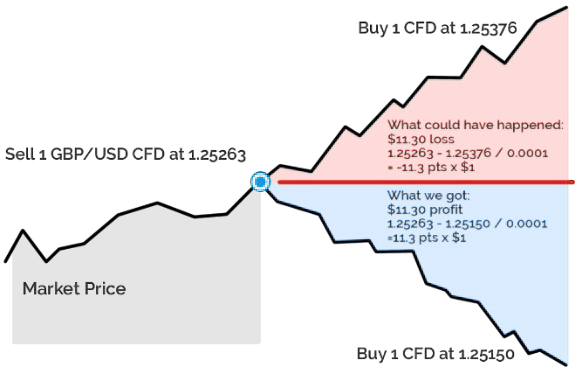
0.00113 / 0.0001 = **11.3 points**

We know from the market information and the deal ticket the GBP/USD CFD has a value of $1 per point:

11.3 x 1 = **$11.30**

This dollar profit is automatically converted back to the trader's account currency – £ – by the broker, so our trader has ultimately made a profit of **£9.02.**

The trader called it right and made a profit, had the price risen they would have lost money.



Successful GBP/USD CFD trade

We've shown you quite a detailed CFD trade here, the points to note are:

- The trader made money because they went long US dollars because they thought it would appreciate again Sterling, which it did.
- The P&L is in the quote currency – in this case, USD. The trader's account currency is GBP so their broker converted the USD profit back into GBP.
- The profit would likely attract capital gains tax. Had there been a loss it would likely be tax-deductible.
- The trade was not held overnight, but if it was the trader would pay the interest rate of the currency, they are long and receive the interest rate of the currency they are short. These would get netted to the tom-next rate and there would have been a small fee on top to roll it.
- There was no stop-loss order set, this was bad risk management, had the price tracked further up it could have created a significant loss.

Chapter 12 – EUR/USD Spread Bet

Let us take you through a worked example of a spread bet in EUR/USD.

This is the third worked example of three, where we are taking you through the currency trades using spot Forex, a CFD, and a spread bet.

For the sake of our example, we'll assume our trader wants to go long EUR/USD. This means they think Euros will appreciate against the US Dollar. How they came to that view is not relevant for this chapter – but we hope it came from good analysis and was part of a thought-out trading plan.

For the sake of this example we've assumed the trader is based in the UK, they have chosen to trade with an FCA regulated broker and the currency they fund their account with Pounds Sterling.

If you're interested in learning more, we've got a whole guide on Financial Spread Betting.

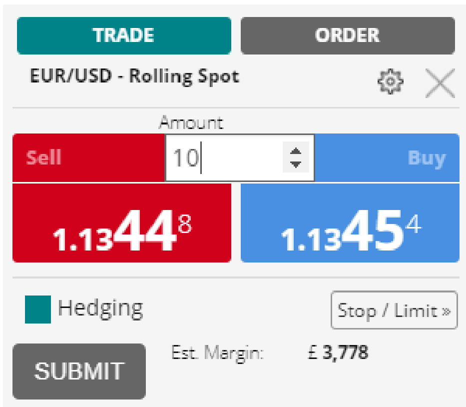
Learn more: Take our premium Trading for Beginners course

A reminder

- In a currency pair, the first currency in the pair – the one on the left – is always called the base currency. The second currency – the one on the right – represents the quote currency.
- In Forex trading, you're always exchanging two currencies. If you think the base currency will strengthen against the quote currency, you would buy the currency pair. Conversely, if you believe the base currency will weaken against the quote currency, you would sell the currency pair.
- In a quote from your broker, the bid price – also known as the sell price – is where you can short the pair, while the ask price – the buy price – is where you can go long the pair.
- Spread bets are traded in amounts per point.

Going Long EUR/USD with a spread bet

Our trader opens up their broker's trading platform, finds the EUR/USD currency pair and opens up a deal ticket for the rolling spot spread bet.



EUR/USD – Rolling Spot

The trader can short the pair at the sell price of 1.13448 or long at the buy price of 1.13454. Our trader wants to go long because they think Euros will appreciate. The base currency is Euros and the quote US Dollars – this means the price is how many Dollars 1 Euro is trading at.

The trader opens up the market information tab to check a few things. The 'trade per' is 0.0001, this means a 0.0001 move in price is one point. So, 1.13454 to 1.13464 is a one-point move – this is important because the trader sets the amount they want to bet per point. The trader decides they want to bet £10 a point – a decent sized bet.

Trading Hours (London time)	00:00 - 22:00 & 22:05 - 23:59		
Margin Required	3.33%	**Trade Per**	0.0001
Current Spread	0.6	**Min Trade**	GBP 0.5
Commission	N/A	**Expiry**	Rolling

How much margin

The second piece of information noted from the market information tab is the 3.33% margin required.

This ties into the maximum amount of leverage allowed in the EU on a major forex pair being 30:1 (100/30=3.33).

The deal ticket provides an estimate of margin – £3,778 but the trader works it out from the bottom up:

1.13454 / 0.0001 = 11,345.4 points

11,345.4 points x £10 = **£113,454** notional exposure to the pair

x 3.33% = **£3,782**

This checks out – it is not exactly the same as the deal ticket because the ticket only estimates margin. The precise margin, the one we've calculated, will be held as a deposit when the trade is placed.

Our trader has £50,000 of trading capital in their account and no other open trading positions so they can fund this position comfortably.

Before placing the trade, in the open deal ticket, the trader sets up a stop-loss order at 50 points. Because they are going long this is set at 1.12954, below the current price. This means, for a £10 a point bet, they are risking £500 – 1% of their trading capital on this one trade.

They set up a limit order 150 points away, above the market price, at 1.14954. This means their take profit target, if hit, will make them £1,500.

The trader is happy with everything so places the Buy **EUR/USD £10 a point at 1.13454**. The stop and limit orders will be placed at this point as well.

Unlike with the spot Forex or CFD examples, where our trader didn't have them, with the take profit and stop-loss orders set, the trader can go and do something else, they don't need to be glued to their trading screens waiting for the price to hit their targets and manually placing the sell trade to close the position.

Outcome 1 – winning trade

The trader comes back to their account and sees their position has been closed by the limit order set at 1.14954. What actually happened was the price moved through the order quickly, it was triggered and the broker filled the sell £10 a point order at 1.14962.

The profit on the trade is worked out as follows:

(Exit price – entry price) / trade per = profit (or loss) in points

(1.14962 – 1.13454) / 0.0001 = 150.8 points

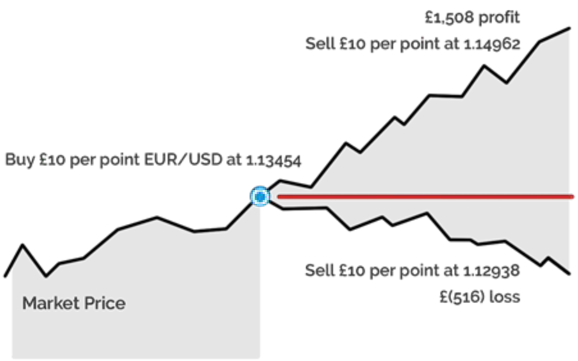
150.8 points x £10 per point bet = **£1,508 profit**

Outcome 2 – losing trade

The price falls and triggers the stop-loss order at 1.12954. The price was again moving quickly and the order to sell £10 a point was filled a 1.12938.

(1.12938 – 1.13454) / 0.0001 = (51.6) points

(51.6) x £10 = **£(516) loss**



Spread bet example

We have shown you quite a detailed spread bet here, the points to note are:

- The trader does not have to wait for their stop or limit orders to be a trigger – they could have initiated the sell £10 a point closing trade any time after placing the opening trade.
- The P&L is always in £, the exposure to the EUR/USD pair is in £ – this is because it's a spread bet in £, the trader's base currency is set when they opened the trading account.
- The trade was not held overnight, but if it was there would have been a small overnight charge to fund and roll it.
- The profit would likely be capital gains tax-free. The loss would likely not be tax-deductible.
- It is important to note the trader is not forced to set stop or limit orders, but it is good risk management practice to do so, so we've shown it.
- The difference between an order's price and the actual price it is filled at is called slippage, this occurs in fast-moving, illiquid or markets when they reopen.

Chapter 13 - Make a Living Trading Forex

If you are new to trading, you might well wonder if it is possible to make a living from currency trading, given that the majority of small traders do not.

The short answer? **YES!**

It is possible to make a consistent income from Forex trading.

We're at the start of **Part III** of the guide where we'll show you how you might start making money from Forex trading. So, what are your chances of becoming a successful Forex trader, and how much can you make? Let's jump right in.

Learn more: Take our premium [Trading for Beginners] course

Becoming a professional trader is possible

The issue with many new traders is that they underestimate the level of commitment required to really succeed. They're not ready to do what it takes to become a real trader.

They don't spend enough time and energy to develop their patience and discipline, to build a winning attitude with a realistic mindset, or acquire the trading skills and knowledge that will allow them to be consistently profitable.

They often give up at the slightest mistake or challenge, or make undisciplined, wild trades which frequently leads them to lose more than they should do.

To be able to build a career as a full-time Forex trader, there are many things you'll have to do right over the long-term.

"The goal of a successful trader is to make the best trades, money is secondary"

- *Alexander Elder*

Whether you're a part-time or full-time independent trader, your main goal should primarily be to be a good trader. The money will follow.

Create your trading routine

For that, you need to act like a professional trader, and create a trading environment and routine that a professional trader would follow.

For traders, a routine is useful

If you think about it, most professionals follow some kind of a routine, whether that be singers, athletes, or doctors. It helps them maintain a certain level of discipline in their process. For traders, a routine is useful, because it allows them to follow a certain path when they plan their trades and trade their plans. This maximises positive outcomes and negates trading mistakes.

Don't worry, creating a trading routine is easy – you just need to remain motivated and committed over time. The most important thing is to develop your own trading routine, one which fits your trading style and daily life.

To achieve that goal and boost your performance while continually progressing, you'll need to:

- ✓ Honestly assess your understanding of trading, know yourself very well, and recognise the things about yourself that affect your discipline, patience, focus, and follow-through.

- Have a sound knowledge of how trading and the currency markets work.
- Keep in mind your end goal.
- Create and follow a profitable trading system with solid risk management (risk-reward ratio, win rate, stop-loss and take-profit orders).
- Know how to adapt yourself and your trading strategy to changing market conditions over-time.
- Track your progress with a trading journal, and monitor your track-record.
- Develop winning habits and adopt a positive mindset to be able to get over the obstacles of Forex trading, as well as overcome your own unhelpful tendencies (over-trading, trading out of boredom, trading impulsively, and cognitive biases such as anchoring, recency, confirmation, addiction, loss-aversion, etc).
- Keep learning to optimise and improve your personal skills and your trading practices.

How much trading capital should you start with as a Forex trader?

Nowadays, you can start trading with as low as £100, but don't expect to make a living with such a small amount of initial capital.

How to work out how much capital you need

The key is to set reasonable expectations of return or you're just going to make mistakes, like over trading, trying to achieve it.

Step 1: Start by setting an amount you want to make per year from trading.

Step 2: Set a reasonable expectation of return. For a very good trader would be 15-25% per year – remember if you're new to trading this is unlikely to be you just yet.

Step 3: Desired income / return % = capital required. So if your desired return is £5,000 per year and your expectation of return is 20% you need capital of £25,000 to achieve it (5000/0.2=25000).

This is the easy bit, you now need to learn how to make that sort of return consistently.

Part-time vs. full-time traders

It's easier to start small in order to test your trading strategy, to learn how to follow your trading plan no matter what, and to build confidence in order to become a good trader, while earning extra money to complement your salary.

You'll also have less pressure and emotional attachment than if you had to trade for a living straight away, because you still have the benefit of income from your job. You can then focus on becoming a good trader that makes profits each month.

If you can make winning trades and constant profits with a small/medium trading account, then you can do the same with a bigger account.

Determine the right approach for you

If you're brand new to trading, it's risky to start using real money before you understand how trading works. Invest in yourself by improving your trading knowledge, so you avoid making costly mistakes that take you out of the game before you've even got started.

Learn more: Take our premium Trading for Beginners course

Once you learn more about these trading practices, you can determine the way you approach the market.

Ask yourself:

- How available are you to trade?
- Are you going to use technical or fundamental analysis?
- Are you going to develop automated trading strategies, or rather use discretionary trading techniques?

Thinking about trading approaches, you'll come to realise that what your Forex broker provides for analysis isn't enough. Your trading system may require purchasing additional software, trading tools, or powerful news feeds, for instance.

Once you know how much trading education you need, and if you're going to require additional tools to properly trade, remember that you will need to trade large enough trading positions to be able to make money to sustain a healthy income.

You will also need to make sure you're not placing excessive risk on one single position.

How much money do Forex traders make?

We've all heard of stories of Forex traders that made millions in the markets in the short term.

You can get inspired by these stories, but don't compare yourself to these people – their situation is completely different. You have different starting capital, risk tolerance, trading method, risk and money management rules, trading experience, etc.

Despite these stories, trading isn't a "get rich quick scheme" – it's a business, one that requires work and dedication to grow over time. Knowing exactly how much money Forex traders earn every month or every year is impossible. No one really knows.

But there are some elements you can take into consideration to get a good estimation of how much money you can make from FX trading. Key elements to consider:

- What is the size of your trading account?
- How many trades will you do per year?
- What is your expected return for every dollar you risk (trading expectancy)?
- How much you will risk per trade?
- Will you withdraw your profits, or not?

When you know all these you can estimate how much money you might make – this analysis is easier to do once you have a track record to look back over.

In any case, the odds of you building a successful trading career are good if you start acting like a professional trader, with realistic goals set in place and a sound trading strategy with a positive expectancy.

Find inspiration and motivation in other famous Forex traders' paths to create your own success

Like any other kind of job, Forex trading requires that you learn the right trading skills and techniques.

Learning from (or better yet, with) mentors who are successful and experienced Forex traders is probably the easiest and most effective way to receive the required trading knowledge and practice to forge your trading career.

Reading the stories of profitable Forex traders' road to success can also give you ideas on what to do, as well as which mistakes to avoid, without sacrificing any of your trading capital.

So, who are the best Forex traders in the world you can read about?

George Soros, Bill Lipschutz, Paul Tudor Jones and Stanley Druckenmiller are frequently listed amongst the best Forex traders. They all have a story to tell, not only of their successes but also their mistakes. All of them have a lot to teach you on how to profit and make money with Forex.

We would recommend you can get yourself a copy of Market Wizards by Jack D. Schwager it is a fantastic insight into some of the world's biggest traders.

So, consider this…

> *"Every battle is won or lost before its ever fought"   - Sun Tzu*

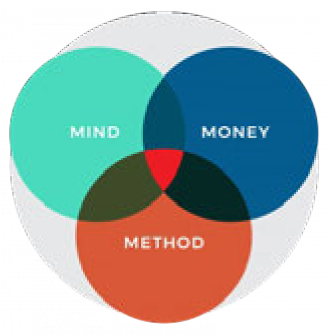
Entering trades is like a battle – if you want to win it, you need to be ready and prepare for it. Markets are unpredictable, and you can't predict every possible scenario, but what you can control is yourself.

Chapter 14 – Mind, Money, Method

To become a successful Forex trader, you need to master different techniques and concepts that will allow you to spot the best trading opportunities.

At the same time protecting your trading capital and having the right psychological approach.

Learning all of this through an efficient, structured, and professional framework will greatly improve your understanding and knowledge of Forex trading.



The three M's

There is a framework by which all of these things can be learned – we call it the three M's: Mind, Money and Method, and we teach it in our courses.

Learn more: Take our premium Trading for Beginners course

Mind, Money and Method

Learning how to become a profitable Forex trader is based on your capacity to develop a proven profitable trading strategy over-time – a Method.

However, you cannot properly execute this trading method if you do not understand and control your risk, that's why money management in Forex trading should be an essential component of your trading strategy – Money.

It's worth mentioning that, even if you have the best trading method in the world – one that finds great Forex trading opportunities with appropriately applied money management techniques – if you're not able to control your emotions and to follow your trading plan (Mind), you'll not be successful.

So, let's dig a little deeper into this Mind, Money and Method framework.

Mind – the psychology of trading

The market influences trader psychology, as much as investor behaviour influences the market.

Unfortunately, traders often underestimate the importance of trading psychology on their path to success, but it's essential to take the time to understand and develop certain techniques and adopt the psychology of a winning Forex trader.

As emotions very often lead to mistakes when trading, your ability to contain your emotions and exercise discipline will enhance the chances of success over the long run.

So, how do you beat your emotions?

The field of Forex psychology has developed many sound methods for overcoming your unhelpful biases and emotions.

The most effective and easiest to implement are the following 3 concepts:

1. Be aware of the emotions and psychological biases that affect your trading

Emotions and psychological biases have no place in trading, as they affect your analytical skills and the way you make trading decisions.

Being aware of the various Forex market psychology traps that can influence you while trading is the first step in overcoming and controlling your emotions.

The emotions experienced in trading are wide-ranging, on any given day a trader can feel: doubt, pride, euphoria, panic, hope, fear, greed, boredom, frustration, regret, impulsivity and revenge, to name just a few.

In contrast to the Efficient Market Hypothesis, which states that the market is rational, behavioural finance is the study of the effects of different factors (such as social, cognitive, and psychological) on our economical and investment decisions.

It also has consequences on fund allocation, diversification, market prices, and profits/losses.

Psychological biases, also called cognitive biases, describe the irrational decisions that we as humans tend to make. Daniel Kahneman, considered the father of behavioural finance, gives many examples of the different kinds of psychological biases that affect our decision making in his book "Thinking, Fast & Slow".

Here are the most important cognitive psychological biases in decision-making you need to be aware of as a trader or investor:

Availability heuristic
Choosing first the information that is easy to find and easily remembered.

Confirmation bias
Looking for information that confirms your existing beliefs.

Loss aversion
Preferring not to lose £10 than to find £10.

Anchoring bias
Relying too heavily on the first piece of information that you find, known as the "anchor".

Overconfidence bias
Overestimating your capacities (also known as the Dunning-Kruger effect).

FOMO (Fear Of Missing Out)
Jumping into a trade without really thinking due to fear of missing out on a great trading opportunity.

2. Set realistic trading goals to achieve better trading results

Once you're aware of the emotions and psychological bias that can influence your behaviour, you need to set realistic and achievable trading goals to fight your emotions.

It's important to be able to monitor and measure your success in achieving your objectives.

A great way to start planning realistic goals is to use the SMART goal method to bring organisation into your trading goals, so then you can clarify what you want to achieve, so then you can focus your time and energy into achieving it.

A SMART goal is Specific, Measurable, Attainable, Relevant and Timely.

3. Plan your trades to automate your trading process

Finally, you need to create a trading strategy to follow, so when your emotions are left behind: you're simply following your trading plan, where every step of your trading style, method and money management is planned out.

We'll elaborate on this point in the "Method – The trading plan" section.

All of these steps will help you to be prepared and to combat any toxic behaviours so they don't negatively impact your performance. Don't let your emotions take over – be the one in charge!

Money – the money and risk management element

It's impossible to create a trading system that is 100% profitable.

Losses are part of your trading journey and it's important to accept them. However, to be successful and make money on the markets, your profits overtime should always be higher than your losses.

Every day, there are traders that are wiped out, mostly because they didn't use a trading strategy that properly accounts for risk. Perhaps they didn't use a stop-loss and take-profit orders, used too much leverage, risked too much on a single position, averaged up/down, or didn't diversify their portfolio well enough.

Even a good trading system can lose money if no money and risk management is taken into account, as the latter can turn your strategy into a profitable and reliable one.

The system you build should take into consideration risks and rewards, as the trade-off between the two is what will determine the success (or failure) of your trading strategy.

Money management is then all about maximising your returns at minimum risk with appropriate position sizing, relevant entry and exit strategies, diversification, and execution methods.

Method – the trading plan

As we explained, having a trading system to follow will help you trade according to a structured and detailed process.

Every time you're in front of the markets, the emotional side attached to trading will be greatly reduced

This method is key to your trading success, as it should describe every single step of your decision-making process, including the method you use to analyse the market (technical analysis or fundamental analysis). It should also describe how much of your capital you'll be allocated to each position, and how you're going to manage your trading position once opened.

Every time you're in front of the markets, the emotional side attached to trading will be greatly reduced. You'll be more objective, because you'll know exactly what to do when good trading setups appear.

When back-testing your trading system, it's important to not fall into the trap of curve fitting – that is, creating a system that achieves optimal returns based on the very specific conditions of the tested historical data.

A strategy this specific will fall apart as soon as market conditions change. You want to create a system that performed reasonably well in the past, with wide enough parameters to take into account future trading conditions and remains profitable.

Mind, Money and Method – the framework we teach

The "Mind, Money, and Method" framework is a very useful framework to follow when learning how to trade.

Learn more: Take our premium Trading for Beginners course

If you keep it in mind while learning to trade, mastering all the required trading skills and techniques will be a manageable task that will see you leaps and bounds ahead of the competition.

Chapter 15 – Forex Risk Management Strategies

It is pretty common for new Forex traders to think making money through online Forex trading is fast and easy.

However, it's a process that takes time, dedication, commitment, and patience, if you want to be successful and profitable in the Forex markets in the long run.

You can't just open a position in your trading platform without taking into account the trading conditions set by your Forex broker, the market, leverage, liquidity and counterparty risks, that affect your capital. A legendary Forex trader once said:

> *"Don't focus on making money; focus on protecting what you have"*
>
> *– Paul Tudor Jones*

You also need to apply tools and techniques to manage your money and risks – if you don't do those things, you wouldn't be trading – you'd be gambling.

#1 Only trade money you don't need

It might sound obvious, but the first rule in Forex trading, or any other kind of trading for that matter, is to only risk the money you can afford to lose. Many traders, especially beginners, skip this rule because they assume that it "won't happen to them".

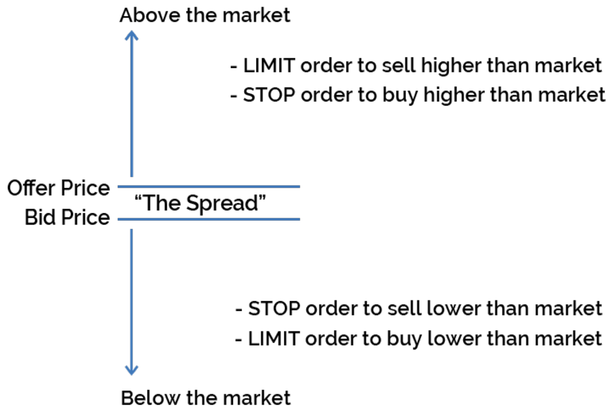
If trading were like gambling at a casino, you wouldn't take all the money you have to the casino to bet on black, right? Well, it's the same with trading – don't take unnecessary risks by using the money you need to live on.

Why?

Because it's possible to lose all your trading capital, and secondly, because trading with funds you live on will add extra pressure and emotional stress to your trading, compromising your decision-making abilities and increasing the chances of making mistakes.

The Foreign Exchange markets are volatile, so it's better to trade "conservative amounts" from your disposable income. If you can't afford to lose the money you're trading, then, unfortunately, trading is not for you.

#2 Always use stop-loss and limit orders



Stop-loss and limit orders

Orders are instructions to your broker to place a trade when the price in the underlying market hits a certain level. By way of a reminder, here is how stop and limit orders work:

Stop-loss orders are placed on an open position to get you out of a trade if the market moves against you, it 'stops your loss'.

There are three reasons why you should set stop-losses and limit orders on every trade:

- It is just common sense to protect your downside.
- Your mindset is better, you can leave your trading screen knowing there is some degree of protection in place.
- The process helps you sense-check the trade against your trading plan.

#3 Think about your risk tolerance

Before you start trading, you need to determine your risk tolerance, depending on:

- Your age
- Your knowledge of FX trading
- Your experience
- How much you're willing to lose, and
- Your investment goals

Having a feel for your risk tolerance is not just about helping you sleep better at night, or stress less about currency fluctuations. It's about knowing you are in control of the situation because you're trading the right amount of money vis-à-vis your personal financial situation in relation to your financial objectives.

Keep your trading within your risk tolerance and you increase the likelihood of trading success.

#4 Set your risk/reward ratio to a minimum of 1:2

Knowing about the risk/reward ratio (RRR) will definitely improve your chances of becoming profitable in the long run, and setting stop-loss and limit orders that protect your capital.

A RRR measures and compares the distance between your entry point and your stop-loss and take-profit orders.

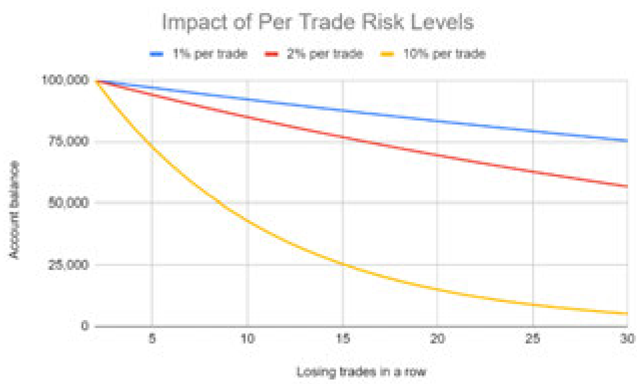
We'll get onto trading styles in the next chapter but scalpers and day traders should aim to have a minimum RRR of 1:2, longer-term swing and position traders should aim for a wider minimum of 1:3.

#5 Control your risk per trade

You also need to consider your risk per trade as a percentage of your trading capital and set it at a conservative level, this is especially important when you're new to trading and are likely to make more mistakes than someone with experience.

You should only risk a small portion of your trading capital per trade: a good starting point would be to not risk more than 1% of your available capital per trade. If you're applying sound RRR then that means risking 1% to potentially return 3%.

Here is the impact of three different per trade risk levels – 1%, 2% and 10% – on an account balance of 100,000 over a 30 trade losing streak. The trader risking 10% per trade has lost 95.3% of their account balance, the trader risking 2% is down 44.3% and the 1% trader is down 25.2%.



Impact of Per Trade Risk Levels

We're showing you this to make the point that the more a trader risks per trade then the harder it is to rebuild capital after a series of losing trades, although it might not be 30 in a row, which is very unlikely, losing streaks do happen – to every trader at some point – and you don't want them wiping out your capital so you can't rebuild.

#6 Keep your risk consistent

Most beginners will increase the size of their positions as soon as they're making profits, which is one of the best ways to get your account wiped out. Keep your risk consistent.

Do not become over-confident and less risk-averse

Just because you've made a few winning trades doesn't mean the next one is going to be profitable.

Do not become over-confident and less risk-averse, as that will lead to you changing your money and risk management rules without solid reasons.

When you worked [on your trading plan](), you had to set up rules to decide about an effective size for your positions. This is just one step in establishing a successful trading method, now you need to stick to and follow your trading plan!

#7 Understand and control leverage

The three margin products we've introduced so far in the guide – spot Forex, CFDs and spread bets – are all leveraged products.

Leverage means that you can trade more money than your initial deposit, [thanks to margin trading](). Your broker will only ask you to put aside a small portion of the total value of the position you want to open as collateral.

When using leverage, your profits can be magnified quickly, but remember the same applies to your losses in equal measure. This is why you need to understand how leverage and margin trading work, as well as how they impact your overall performance and trading.

Forex traders are often tempted to use high leverage to make significant profits, but if you're over-leveraged one quick change in the market, or a simple mistake, could end up with an outsized hit.

To note

In August 2018, the European Securities and Markets Authority (ESMA) [imposed limitations on the leverage offered by brokers](). These leverage limits on the opening positions by retail traders vary depending on the underlying:

- 30:1 for major currency pairs, and
- 20:1 for non-major currency pairs.

ESMA did this for a reason: retail traders, especially new ones, are normally bad at managing leverage and end up losing money because of it.

If there was only one titbit you took from the whole guide it would be to really learn about how leverage risk works and how you need to actively manage it to be a good trader.

#8 Take currency correlations into consideration

Because currencies are priced in pairs, it's important to understand that currencies are linked to each other, or [correlated]().

Knowing about Forex correlations will help you better control your Forex portfolio's exposure by reducing the overall risks.

Correlation represents a measure of how one asset's price changes in relation to another.

If two assets are positively correlated, it means that they tend to move in the same direction, while if they are negatively correlated, they will evolve in opposite directions.

To use FX correlations to your advantage, you need to remember a few things:

Avoid opening several positions that cancel out each other

For instance, if you go long on the EUR/USD and the USD/CHF, you can expect both currency pairs to evolve in opposite directions, which is almost like having no trading position in your account.

Why?

Because the USD is used once as a base currency (USD/CHF), and once as the quote currency (EUR/USD), which means that if the USD strengthens against its major counterparts, then the EUR/USD will go down, while the USD/CHD will go up – the evolution of one exchange rate cancelling out the other one.

Avoid opening positions with the same base currency, or quote currency

For instance, if you go long on the EUR/USD, the AUD/USD, and the GBP/USD, you can expect these currency pairs to be positively correlated because they all have the same quote currency, the USD.

It means that when the USD strengthens/weakens, your portfolio will go up/down.

Be aware of commodity currencies

Commodity currencies represent currencies that move in accordance with commodity prices, because the countries they represent are heavily-dependant on the export of these commodities.

As a general rule, if the price of commodities strengthen, then the currencies of the commodity producers will go up – and vice-versa.

The main correlations to know about are the Canadian Dollar (CAD) and oil, the Australian Dollar (AUD) and gold/iron core, as well as the New-Zealand Dollar (NZD) and wool and dairy products.

To improve your Forex trading performance, you should understand your exposure: some currency pairs move together, while others evolve in opposite directions. The key is to diversify your portfolio to mitigate risks.

Learn more: Take our free Mastering Trading Risk course

Bottom-line

These pointers are just the cornerstone to better manage your risk – as you research further, you'll find other Forex trading tools and techniques for beginners you can use to improve your trading strategy.

Before using a live trading account, try to back-test your trading plan on a demo account, and improve your strategy if needed.

Review your trades on a regular basis with a trading journal that will help you understand what you did right, and what you can improve.

Learn from your mistakes, and accept responsibility for losses.

Regardless of the timeframes you use, whether you rely on technical analysis or fundamental analysis, always follow your trading plan. Control your emotions and be patient enough to wait for your trade setups to be confirmed before opening/closing a position.

Chapter 16 – Developing Winning Forex Strategies

You should now have a pretty good handle on how Forex works so let us turn our focus to how you might go about developing a winning strategy.

These are the broad steps to follow to develop a winning Forex strategy that you can stick to.

- Determine which kind of trader you are.
- Choose which trading style suits you best.
- Define your method of entering/exiting the market.
- Define your risk.
- Back and forward-test your system.

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Step 1. Which kind of trader are you?

Why is it so important to figure out your trader personality profile? The power of knowing which kind of trader you are will allow you to focus your time, energy and attention on developing Forex trading strategies that work with your trading style.

Sometimes the best way to make money for one type of trader can be a poor fit and a losing strategy for another type.

Learning how trading Forex works and how to make it profitable is hard enough, so working on strategies with the highest probability of working out for you will simplify the whole process and give yourself a better chance to succeed.

How to determine your trader profile

Ask yourself:

- Why do you want to start trading in the first place?
- What do you hope to achieve?
- What is your general knowledge of the markets and their correlations, trading, money management, trading psychology, trading platforms, Forex brokers and financial products?
- How much education will you need before starting trading?
- How often will you be able to trade?
- Will your dedicated trading time be fixed, or do you have to be flexible?
- What will your risk level be?
- How well can you control your emotions and your stress?
- Do you prefer to see the results of your trades within the same day, or can you wait a few days for your trades to play out?
- How often would you prefer to check your trades?

- Will you use technical or fundamental analysis to determine your edge and ultimately your entry/exit setups?
- What amount of money can you allocate to Forex trading?

Step 2. Which trading style suits you best?

Once you've answered all these questions, you will start to see where you fit within the trading spectrum. There are a few different types and categories within which you'll fit:

- A trading timeframe preference: scalper, day trader, swing trader, position trader
- A type of trading analysis preference: technical trader, fundamental trader
- A risk tolerance preference: risk-averse, risk-neutral, risk-loving

You will be one of four types of trader: Scalper, Day, Swing or Position.

Scalping and day trading

These two kinds of trading are the most active and aggressive type of currency trading, as they both imply that all your trading positions will be opened and closed within the same trading day.

Scalping in the FX market is about buying and selling currency pairs with a target of a few pips, held for no more than a few minutes, or even seconds. Day trading targets more pips and positions can be open for a few hours.

These trading styles work with very short-term trading strategies to make tiny but consistent profits and increase returns through high leverage.

Both strategies can be stressful and require being able to stay extremely focused and available in front of your trading desk while you're trading.

- Do not like to hold your positions overnight and prefer intra-day trading.
- Like to know if you earned or lost money at the end of your trading day.
- Tolerate a high level of market and leverage risk.
- Are available to be in front of the market and quickly react to potential opportunities.
- Can deal with a relatively high level of stress.
- Like fast-paced trading.

Swing trading

This trading style is a medium-term approach based on taking advantage of changes in the momentum of a currency pair within the primary trend. Traders typically hold positions from a few days to a few weeks.

Swing trading requires a lot of patience, as you'll be holding your trading positions – normally with a fair degree of leverage – for several days or weeks.

It's ideal for engaged part-time traders, as they don't always have the time to analyse the market every day.

- You don't have much time to spend in front of the screens every day.
- You can hold onto your positions for days/weeks.
- You favour technical analysis.

Position trading

This trading style is a long-term approach based on taking advantage of changes in the long-term price of a currency pair. Traders typically hold positions for a few weeks, months and even years.

Traders take a position and hold it; they are not bothered about short term fluctuations in price.

Typically, these positions are either taken in the currency futures market – where funding is priced in – and with a prudent amount of leverage. Position traders might only do their analysis every month or so and are seeking to identify and trade big trends.

Position trading is for you if:

- You do not have much time to spend in front of the screens every week.
- You can hold onto your positions for months or years.
- You don't want to use much leverage.
- You favour fundamental analysis.

When figuring out which trading style best suits your personality, you need to take into consideration all of the following elements: your current schedule, your attention span, and your risk aversion.

Consequently, you need to match your selected timeframe with your lifestyle and personality.

With position trading, you might trade using a daily timeframe. With swing trading, you may stay in position from a couple of days to a few weeks, while using 4-hour to daily charts. With scalping and day trading you will stay in a position anywhere from a few seconds to a day, using anything from tick to hourly charts.

Step 3: Which kind of analysis method will you use to make your trading decisions

There are a few types of analysis that could be a good fit for your personality. You could be a noise trader, a sentiment trader, an arbitrage trader, and a market timer, but the most common ones are technical traders and fundamental traders.

Technical traders

Technical traders use technical analysis to analyse an asset's price movements using past prices to forecast future price action.

They use trend analysis, support and resistance analysis as well as mathematical and technical indicators, Japanese candlestick analysis, market theory and price pattern analysis to trade.

Fundamental traders

Fundamental traders look at fundamental factors to determine the intrinsic value of a financial asset and define if it's undervalued or overvalued, and whether or not the asset should be bought or sold.

A fundamental Forex trader will predominantly use news trading or currency carry trading strategies, mostly based on interest rates changes that have the highest impact on the evolution of exchange rates.

Step 4: Which method will you follow to enter/exit the market?

"Good technical analysis will tell you 'when', good fundamental analysis will tell you 'why'"

We think both analysis methods should be used.

On the Forex markets, traders usually rely on technical analysis to time their entry and exit from the market, while still keeping an eye on the economic calendar to keep abreast of news that can affect market volatility and trigger potential trading opportunities.

Once you know which kind of market analysis to use with your trading style, you have to spot and understand the market phases. There are different tools and indicators that work best under certain market conditions.

Learn about Technical Analysis

We've got dozens of free courses where you can learn about technical analysis. Instead of repeating lessons from our courses here, we'd encourage you to take them to learn more. Our popular ones are:

- Take our free course: Technical Analysis Explained
- Take our free course: Trends, Support & Resistance
- Take our free course: Japanese Candlesticks Decoded
- Take our free course: Reversal Price Patterns
- Take our free course: Continuation Price Patterns
- Take our premium course: Trading for Beginners

Define which trading conditions are best for your trading style

Whether you're using a short-term approach such as the Forex scalping, or a longer-term one like swing trading, you need to determine specific set-ups you want to be targeting to be profitable, these include:

- Hedging
- Forex arbitrage strategy
- Forex pullback trading strategy
- Breakouts
- Forex trend strategy

Once you know which trading conditions you prefer to trade – ranging markets, trending markets, volatile/non-volatile markets, pullback or breakout phases – you can specialise in the market phase and learn how to master the trading indicators and tools used to identify it.

Or, instead of having one single trading strategy, you could also develop several trading systems for each of the major market phases to better adapt your trading to market conditions, using specific technical indicators, drawing tools, and candlestick patterns.

Learn more: Take our free Simple Breakout Strategy course

Define your risk while following sound risk and money management rules

Determining your risk is all about knowing how much money you're willing to lose on each trading position. Thinking about losing isn't easy, but is necessary to be a good trader.

Knowing the appropriate level of risk depends on each trader and their relationship to risk, as well as how well a trader knows themselves.

There are common money and risk management rules you can follow, such as:

- Only use the money you can afford to lose.
- Adapt your risk management to your trading style.

- Use the right position size.
- Always use stop-loss and limit orders.
- Set your risk/reward ratio to a minimum of 1:2 (1:3 if you're a swing or position trader).
- Risk a maximum of 1% of your available trading capital per position.
- Avoid over-leveraging.

Leverage is a great tool to use to increase your potential profits, but it also increases your potential losses, so use the right amount of leverage for your trading capital and risk tolerance.

Back-testing is the testing of your trading strategy on a set of historical data

Step 5: Back and forward-test your system

Once you've determined which kind of Forex trader you are and what kind of trading style best suits your personality, you need to test your trading strategy with historical data (back-test) as well as with current market conditions and actual trading (forward-test).

This will help you be more confident that you're using a system that makes money, as well as uncover what market conditions are most profitable.

It is also practical to objectively analyse the reliability of your trading strategy and make any necessary changes to improve its efficiency before using real money on a live trading account with it.

What is back-testing?

Back-testing is the testing of your trading strategy on a set of historical data, as if you were trading at that time using your selected strategy.

If the results turn out to be profitable, then your trading strategy has a positive expectancy and you would have made money with it at that time. To get the best results possible, you can refine some of your parameters and retest.

However, it's important not to tweak your variables too much, as you would be creating a trading system that's very specific to the specific market conditions that are inherent to the particular historical data that you used. As a result, your strategy would likely fail to adapt itself to future price movements. This phenomenon is also known as "curve fitting".

What is forward-testing?

While back-testing focuses on a particular set of data with specific conditions in the past (or "in-sample" data), forward-testing broadens the data on which you test your strategy, using live data (or "out-of-sample" data).

Forward testing, often called paper trading, uses a simulated market environment to test your trading system under real-world conditions without putting real money at risk. It works by recording all the buying and selling trading decisions that you would make according to your trading system, and seeing what your "paper" profits would be if you had traded for real.

One way to paper trade is to open a "demo" account – a trading account that mimics real-time market and trading conditions with virtual funds, so then you can determine if your strategy might be profitable.

Whether you're a novice trader, or a more advanced one, paper trading is necessary in your trading journey. As a trader with no previous experience, paper trading is great for getting used to the markets and how trading works, as well as to progress without risking any real money.

If you have more experience, you may find it useful to paper trade to refine your trading system without putting money at risk.

Which data should you monitor?

In any case, the main goal of back-testing and paper trading is to test the proficiency and adeptness of your strategy and its capacity to maintain winning trades with positive gains.

For this, you need to have a certain amount of data about your trading.

Know your data:

Here is a rundown of the data you might start monitoring.

- Date and time of the opening and closing of your positions to compute the length of your position
- The direction of your trade: long or short
- Opening and closing price to compute your P&L
- Kind of trading orders used: market, limit, stop, OCO

Comments about:

- Why you opened/closed your positions
- How you felt before/during/after a trade
- How stressful/confident you were
- What the easiest/hardest part was while trading

Using a demo account gives you access to a lot of data:

- Number of trades
- Average win
- Average loss
- Average risk to reward ratio
- Average trade time
- Probability of win – number of winning trades / total number of trades
- Probability of loss – number of losing trades / total number of trades
- Trading expectancy – (win rate*average win) – (lose rate*average loss) – the amount a trader can expect to make back from every dollar they risk over the long term.
- Profit factor – gross profit / gross loss – to know if and how a trading strategy is profitable and adapted to the trader's risk tolerance.
- Equity curve – the visual representation of the cumulated P&L over a period of time, which illustrates whether the trading account is making money (ascending curve), or losing money (descending curve).
- Maximum drawdown (MDD) – the maximum loss from peak to valley of an investment portfolio – this is a volatility measure that helps to determine the right amount of risk for better capital preservation.

Trading expectancy and Profit factor are among the most important statistics to determine what needs to be changed in your strategy.

Trading expectancy

Trading expectancy is all about the average amount of money you can expect to win/lose per trade. Knowing how much your system can generate will definitely help you better manage your expectations and emotions.

Another important thing to understand is that you don't need to target the highest win rate possible, because this isn't necessarily indicative of a high performing strategy.

The same applies to a low win rate – having a low win rate doesn't necessarily mean that you're losing money.

It all depends on how much you win when you do!

Everything has to be put into perspective in relation to expectancy.

Example 1

Let's say that your trading system wins 40% of the time (therefore losing 60% of the time). Your average win is about 10%, while your average loss is about 5%.
With a trading account of $10,000, your expectancy is positive $100:

(0.4*$1,000) – (0.6*500) = $400 – $300 = $100

Your trading system makes money because you have a positive expectancy of $100, even though your strategy produces losing trades 60% of the time.

Example 2

Let's say your trading system wins 70% of the time (therefore losing 30% of the time), while your average win is about 5%, while your average loss is about 17%.

With a trading size of $10,000, the expectancy of your strategy is negative -$160:

(0.7*$500) – (0.3*$1,700) = $350 – $510 = -$160

This trading strategy loses money because of a negative expectancy of -$160, even though your system produces winning trades 70% of the time.

Profit factor

Profit factor is an easy measure of the quality of your trading system – it is the gross profit on your trades divides by the gross loss, this will tell you the amount of profit per unit of risk.

This number can help you identify the strategy with the highest returns and the lowest level of risk possible.

For example

Let's say that your winning positions have earned $500, and your losing positions are at $350. Your profit factor will be 1.43, which means that you're making money, as when you risk $1 in loss you get $1.43 back.

Profit factor is an important tool when dealing with risk and money management.

How much testing do you need to do?

There is no right answer here, except to say the more the better.

This is a feature of how much historic data you can get your hands on, how often your strategy triggers a trade to forward-test and how much time you have to spare to test.

The more testing you can do and get a positive expectancy on the more confident you can be you have a profitable strategy. The more confident you are in a strategy, generally, the more real money you should be prepared to risk on it.

A final point on demo environments

Moving from a demo account to a real account isn't as easy as you might think, as there are some differences to be aware of that can affect your trading performance.

These differences in trading performance are typically technical and behavioural.

Technical differences

Demo accounts usually simulate an ideal trading environment, which is quite different from the real world. This is especially true when it comes to processing orders, execution latency, re-quotes and slippage.

Behavioural differences
Trading with a demo account is, psychologically speaking, completely different – you're not using your own money. Most traders underestimate the importance of trading psychology in their performance, emotions often take over reason and technique.

Another psychological factor is the fact that a demo account will offer you more virtual funds than what you would normally use, which nudges you towards making riskier trades than what you would otherwise do in real-life.

In summary

When deciding how you should start Forex trading, remember to follow these 5 steps:

- Determine which kind of trader you are.
- Choose which trading style suits you best.
- Define your method of entering/exiting the market.
- Define your risk.
- Back and forward-test your system.

Whether you're using a simple Forex strategy, or a more advanced Forex strategy, you need to master it before you start trading for real.

Chapter 17 – Technical vs Fundamental Analysis

For an aspiring trader, one of the first things that should be taken care of is the building (and following) of a comprehensive trading strategy.

As we discussed in the previous chapter, this strategy should be based on your trading style, risk aversion, trading capital, financial goals and the method by which you're going to analyse the market – your edge.

In this chapter, we're going to start to introduce you to the main methods of analysis Forex traders use and the strategies they yield.

Learn more: Take our premium Trading for Beginners course

Types of market analysis

There are two broad methods of market analysis, briefly introduced in the last chapter, that will help you decide when and how to trade:

Fundamental analysis

Fundamental analysis is the study of economic, social, as well as political forces that affect the supply and demand of a financial asset and the risks that influence its price.

Technical analysis

Technical analysis studies the price movement of an asset, mainly through charts, in order to determine profitable entry and exit points.

Which is the best analysis method?

The answer is both!

> *"Good technical analysis will tell you 'when', good fundamental analysis will tell you 'why' "*

On the Forex markets, traders usually rely on technical analysis to time their entry and exit from the market, while still keeping an eye on the economic calendar – top-down fundamental analysis – to keep abreast of news that can affect market volatility and trigger potential trading opportunities.

Fundamental analysis in the markets

Because fundamental analysts believe all information is not necessarily reflected in the price of an asset, they assume prices and values are different.

Thus, this type of analysis looks at the forces that affect the supply and demand of an asset to work out the value of an asset.

Once fundamental analysts have determined the intrinsic value of an asset, they can compare it with the current asset's price to see if the asset is over – or undervalued. Essentially – value is what you get, price is what you pay.

The overriding assumption fundamental analysts are making here is that price will eventually revert to value.

If the price of an asset is undervalued, then a fundamental trader would probably decide to buy the asset, as they believe the price should go up. Conversely, if it is overvalued, they should sell the asset, because its price could go down.

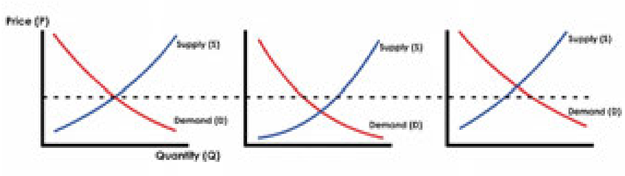
The overriding assumption fundamental analysts are making here is that the price will eventually revert to value.

This is how fundamental traders spot and trade potentially profitable trading opportunities.

Fundamental analysis of currencies

Fundamental analysis in Forex is all about determining what economic factors can affect the supply and demand of a country's currency.

To put it simply, if there is increasing demand, or a reduction in supply, then the trader is assuming the price of a currency will rise. Conversely, if there is a reduction in demand, or an increase in supply, then the price of a currency should fall. If you've ever studied economics, you might remember these supply and demand curves, which explain this relationship:



So, the simplest way to analyse the systematic risks which affect the supply and demand of a currency is to follow an economic calendar. This calendar will help you understand the impact of the weakness/strength of a country's economic stance on its currency.

Usually, when a country's economic outlook is positive, its currency strengthens against its counterparts, as more foreign investors are looking for investment opportunities in this country – and vice-versa.

#1 fundamental strategy: news trading

One of the most well-known examples of a fundamental Forex trading strategy is news trading.

With this strategy, traders open positions based on live economic news being released – either before or after depending if they have a directional bias.

Growth, inflation and employment figures are usually the stats that can trigger the highest volatility

The statistics with the highest impact on the Forex markets are usually the ones that are the most important for the Central Banks – the custodians of a currency.

Growth, inflation and employment figures are usually the stats that can trigger the highest volatility, especially the GDP (Gross Domestic Product), the PCE (Personal Consumption Expenditures) and the CPI (Consumer Price Index), and the unemployment rate as well as the number of jobs created.

With these figures, news traders can take advantage of higher price volatility by determining if the outlook for a country's currency is good or bad, which will impact the demand for a given currency.

#2 fundamental strategy: currency carry trading

Remember that when trading the currency market, you do not trade individual currencies, but currency pairs. You're buying one currency, and selling another one simultaneously.

If you hold a trading position on a currency pair for more than a day, then you'll pay/receive overnight fees depending on the direction of your two positions (long position/short position).

The currency carry trade relies on the differential funding rate between the two currencies – the one you'll pay and the one you'll receive. The idea is to borrow money from a currency with a low-interest rate to buy another currency with a higher interest rate, making a profit from the difference.

For years, the Yen with its ultra low interest rates and the Australian Dollar, with its high interest rates was a popular pair for carry traders.

The carry trade is harder to pull off as a retail trader because of the retail overnight swaps rates.

How to use technical analysis

With technical analysis, traders analyse the historical prices and market statistics of an asset to determine where this asset is going next.

Charts are the best way to visualise past prices and recognise patterns, which can give hints about future price movements if the situation repeats itself.

Learn more: Take our free Technical Analysis Explained course

As well as using charts to study market prices, technical traders also use technical indicators, such as Moving Averages Relative Strength Index (RSI), and Bollinger Bands, to develop their technical trading tactics. We will cover technical indicators in a moment.

Technical analysis is based on 3 key assumptions:

- Prices discount all available information
- Price moves in trends
- History repeats itself

Assumption 1: Prices discount all available information

Technical analysis assumes all available information is already factored into the price of an asset. Consequently, studying the price action of an asset is therefore enough to understand what's going on with the market participants, and there is no need to assess the individual risk factors.

Assumption 2: Prices move in trends

Technical analysis is based on a major concept – market trends. When prices are trending, the assumption is next price movement is more likely than not to be in the direction of the trend, rather than just being random.

When trading, technical analysts are seeking to identify trends. Trends form in one of three directions:

- Upward
- Downward
- Sideways

What is the trend

Identifying trends is everything in technical analysis, as every technique, tool, chart pattern, or indicator has the capability to be used in some capacity to determine the trend, and where the asset is within this trend.

A trend represents the general direction of an asset's price. Charles Dow, considered the father of technical analysis, established that the market has three trends: upward, downward, and sideways (or flat).

To note

An **upward trend** occurs when prices form higher highs and higher lows – this represents a bullish market.

A **downward trend** happens when prices reach lower highs and lower lows – this represents a bearish market.

A **sideways trend** is the default if there isn't an up or downtrend. These often happen when participants are undecided, which means that neither the buyers nor sellers are in control, resulting in sideways moving prices within a range or a lateral consolidation.

Dow also believed that a trend has three parts:

- **Primary** – measured in months or years and represents the general direction
- **Secondary** (or intermediate) – usually represents a correction within the primary trend and lasts between three weeks and three months.
- **Minor** – represents fluctuations in the secondary trend, usually last less than three weeks.

Learn more: Take our free [Trading Theories Explained] course

Assumption 3: History repeats itself

Technical analysts believe that by studying past price movements, they can predict future price actions. The basis of this is market participants behaved in one way in the past and therefore they are more likely to behave in a similar way again.

When they recognise a price pattern that is comparable to what was formed in the past, they know they should buy/sell the asset hoping that the price will evolve in a similar way.

Because market participants keep reacting in the same way, there is a self-fulfilling prophecy aspect in technical analysis.

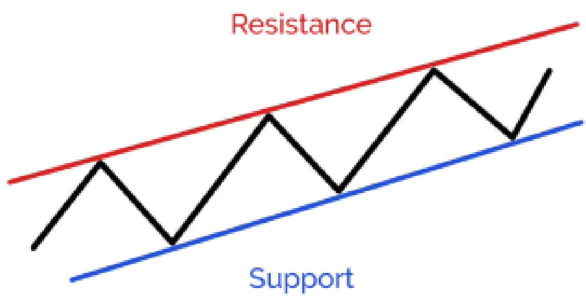
Trendlines, support and resistance

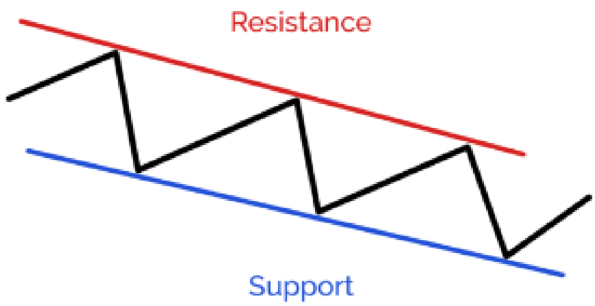
Spotting the trend of an asset's price is the principal objective of technical analysis, and trendlines can help determine potential areas where the trend might be reversing.

> **To be valid, a trendline must be touched by the price at least three times**

A trendline connects significant higher lows if the price is following an uptrend – this is an ascending support trend line. Trendlines connect significant lower highs if the price is following a downtrend – a descending resistance trend line.

To be valid, a trend line must be touched by the price at least three times.





It's also important that there is a psychological reaction when the price touches the trendline with the price going back up, or down. The steepness of the line should also be "normal" – not too flat, neither too steep.

Let's recap

Support and resistance levels are essential to determine the trend of an asset.

They also represent levels where prices could reverse to start a new trend, or a new movement in the main trend.

These levels represent zones that have been tested in the past, meaning that there was a "fight" between bulls and bears to take control of the market direction.

Market psychology plays an important role here, as market participants remember this level as being important – and do not forget that in technical analysis the assumption is history tends to repeat itself.

A support level is usually a level where the bulls take control over the bears, stopping prices from falling. Conversely, a resistance level is a level at which the bears take control to stop the price from rising further.

Learn more: Take our free Trends, Support & Resistance course

What is price pattern recognition?

Price pattern recognition is a very powerful technique when trying to identify a trend. Price patterns are recognisable, repeatable patterns in the price of a market.

There are a few things you need to take into consideration when using price patterns to make your trading decisions:

Prices should be following an established trend: upward or downward – price patterns appearing in sideways trends are usually not valid.

Volatility, the height, and the duration of the pattern in relation to the trend are very important. The bigger the pattern is compared to the previous one and the trend, the more valid the potential outcome would be.

Do not enter/exit the market before a pattern is confirmed. Wait for validation, like a breakout for instance.

Here, it's all about market participant psychological changes that usually materialise themselves in recognisable price patterns. Because traders know about them, they're able to forecast possible outcomes – in short, price patterns give the trader insights around future price direction.

Learn more: Take our free Continuation Price Patterns & Reversal Price Patterns course

The different types of price pattern

There are usually three kinds of price patterns:

Continuation patterns

Continuation patterns describe situations where the price trend is likely to follow the current direction. Among the most common continuation patterns are triangles, flags, pennants, as well as the cup and handle.

Reversal patterns

Reversal patterns signal there is a potential change in the current trend of an asset. The most common reversal patterns are the reverse head and shoulder, double or triple top/bottom, wedges, and the rounding top/bottom.

⟷ **Indecision patterns**
Indecision patterns occur when neither buyers or sellers are in control. Usually, indecision patterns can be spotted thanks to candlestick charts with doji and spinning top being the most common of this kind of pattern.

Technical Indicators

In addition to support and resistance levels, trendlines, channels, and price patterns, technical analysts also use mathematical indicators, or technical indicators, in their Forex trading strategies.

A technical indicator is simply a formula, the output of which is usually displayed below a chart, or next to the price chart to provide additional information about the trend, support and resistance levels, volatility and momentum.

Technical analysts will mainly use indicators either as an alert, or a confirmation, that the current trend might be changing, or accelerating in the existing direction.

Lagging vs. leading indicators

Trend following indicators determine the dynamics and direction of a market like moving averages. These indicators are often referred to as lagging indicators.

Most well-known lagging indicators are the MACD, Paraboic SAR, and Bollinger Bands

As a new trader, it would be wise to start with these, as they will help you confirm the trend after it has been established, allowing you to trade with the trend. Among the most well-known lagging indicators are the Moving Average Divergence Convergence (MACD), Parabolic SAR, and Bollinger Bands.

Leading indicators can then be used to identify entry and exit points, as they provide early signals about a trend reversal or continuation. Oscillators such as the Stochastic and the Relative Strength Index (RSI) are the best kind of leading indicator and help traders spot overbought and oversold situations.

Technical Indicators: Further learning

We've got lots of free courses where you can learn about technical indicators:

- How to Use Technical Indicators
- Moving Averages Explained
- MACD
- Parabolic SAR
- Bollinger Bands
- Stochastics
- Relative Strength Index
- Fibonacci
- Pivot Points

To sum up

In summary, fundamental analysis is more of a long-term approach – essentially it will help explain the 'why' of a price move.

Technical analysis helps in determining more accurate entry and exit points over the short-term – essentially it helps with the 'when'.

While some will argue you need to pick one method and stick to it, our approach is to blend the two, getting the most from each at the right time.

Chapter 18 – New Forex Trader Mistakes

With such low barriers to entry, the Forex markets attract a lot of new traders.

This is especially true as this market is open globally around the clock – giving these new traders greater flexibility regarding when to trade. Initial capital requirements are attractive as well – thanks to the high leverage offered by most brokers, you can get started with just a few hundred dollars.

However, this experience often turns out to be more difficult than anticipated.

We've been there and seen it all before – new traders often make the same mistakes, over and over. If you can eliminate these six mistakes from your trading, you're significantly increasing your chances of success.

Mistake 1: Starting without any education

The most common Forex trading mistake to avoid is believing you can succeed without any experience or trading education. You'd be amazed at how many new traders think they are somehow special and can make money from day one. These fantasies are often short-lived and expensive!

Trading is a skill and like any other skill on the planet, it takes time to get good at it. And, like any other skill, you either develop it through trial and error or you can cut your learning curve by learning from an expert. In practice, you need both.

The problem with trading is newcomers can often confuse luck with expertise. Everyone has almost a 50:50 chance of having a winning first trade, no matter their skill level! You'd never get this with a skill like chess, painting or football – where half the newcomers got the impression, they were experts after their first go at it. However, the fact is over the long-term performance reverts to the trader's mean skill level (their edge).

Investing in a trading education that can truly help you understand how the markets and trading works is indispensable if you want to outperform the masses of other Forex beginners. We hope it is with My Trading Skills, but if we're not for you then please try to educate yourself elsewhere.

Don't run before you can walk! Learn the basics first, start out small and slowly, and forget about being successful with "get-rich-quick schemes".

Investing time and money to get a good Forex trading education is investing in yourself.

Learn more: Take our premium Trading for Beginners course

Mistake 2: Trading without a plan

Because most traders are trying so hard to make the most of the trading opportunities that the markets offer, they forget to follow their trading plan – if they even have one!

This, by the way, is what differentiates a professional trader from a beginner: *the way they approach their daily trading.*

Beginner traders will mostly go from trade to trade without a plan and trade on feelings and whims, while more experienced traders will follow a trading plan and a routine that they spend energy and time to develop.

A trading method should always be part of your trading

A trading method should always be part of your trading, allowing you to make money in a more consistent manner. It allows you to better spot trading opportunities, and better manage your open positions. So now you understand why trading decisions should follow a well-established process according to an effective trading strategy, preferably one that has been back tested.

But having a trading plan isn't enough – you need to stick to it. This will help you become a more experienced trader, especially when things aren't going your way.

Trading approach checklist

Think about the following when deciding on your trading approach:

- ✓ Your knowledge of trading, the markets, economics
- ✓ Your strengths and weaknesses
- ✓ The reasons why you're trading
- ✓ Your financial goals
- ✓ How to deal with big profits/losses
- ✓ Your initial trading capital
- ✓ How much money you can afford to lose
- ✓ The kind of analysis you'll use to spot your trade setups: technical analysis, fundamental analysis
- ✓ Which kind of currency pairs you will mostly trade in: majors, minors, exotics
- ✓ The leverage you'll use
- ✓ The money and risk management rules you'll follow

Mistake 3: Trading without any money and risk management rules

Most beginner Forex traders forget to use a stop-loss order, which is an automatic order that says to your broker to close your position after it reaches a certain level of loss.

If you do not use stop-loss orders, it means that you have an open-ended risk, as your positions can freely fluctuate depending on the market's price movements. Thus, there is a greater risk of exaggerated losses if things aren't going your way, because you're not limiting your losing positions to a certain level, leaving you vulnerable to big swings against your position.

You need to have money and risk management rules hard-baked into your trading plan

If you want your winning trades to be greater than your losing trades, you need to have money and risk management rules hard-baked into your trading plan.

But having money and risk management rules to follow isn't just about using stop-loss orders to cap your losses, there are other things to take into consideration.

Here are some money and risk management pointers:

- → Always use stop-loss and take-profit orders to know in advance how much money you can lose and make on a single trade.
- → Set a maximum loss per week, and immediately stop trading if you reach it
- → Follow a risk/reward ratio of at least 1:2 if you're an intraday trader, 1:3 if you're a swing or position trader.
- → Use proper position sizing – only risk a maximum of 1% of your total trading capital on a single trade.
- → Don't change your risk level as soon as you're making money – keep it constant.

Don't average up/down when the market goes against you.

Mistake 4: Averaging down (or up) to redeem losing positions

You might have heard the saying before:

"Cut your losses and let your profits run. "

Well, when losing money, the prudent thing to do is to cut your losses. However, many traders fail to do so. On the contrary, they hang onto their losing positions in hopes that they reverse, or put up even more money into their losing positions.

Why would beginner traders do that?

Because they hope that the market will evolve in their direction again, and that their current losing positions will turn profitable and make even more money. In most cases, however, their losses are compounded, with prices moving against them longer than expected.

While this common mistake could be slightly less risky if you're a long-term investor, it's too dangerous when you're a day trader in a volatile market such as Forex using lots of leverage.

So, never add to your losing positions!

Open a position with the proper size and use a stop-loss to avoid the temptation of averaging up (or down).

Mistake 5: Using excessive leverage

Not understanding and overusing leverage is probably the costliest mistake new traders make. There was a good reason why ESMA stepped in and capped it for retail traders in the EU – it is very poorly understood.

Leverage and margin trading are amazing tools that help you trade more money than you have in your trading account, allowing you greater market exposure. But this only benefits you if you have a consistently profitable strategy with positive expectation.

Leverage can just as easily magnify your losses as well as your profits, so if you don't have a winning strategy it ends up amplifying losses and mistakes.

Leverage increases profits and losses in equal measure.

For this reason, excessive use of leverage can wipe out your trading capital quickly if not understood and properly managed.

There is also a psychological aspect to take into consideration, as traders often act less rationally when they deal with outsized positions. While using high leverage, there is a greater individual risk on a single trade, amplifying the psychological pressure you have to deal with when trading.

Mistake 6: Having unrealistic expectations

Many beginners start trading currencies with the goal of becoming rich very quickly, which often pushes them into making mistakes.

To stay motivated and disciplined, you need to work on how to set realistic goals

To stay motivated and disciplined, you need to work on how to set realistic goals. If you're not setting goals that are actually achievable, then all that they'll be is a source of frustration and disappointment, rather than a challenging yet reachable target.

To implement significant changes in your trading, you should use the SMART method, so then your goals are Specific, Measurable, Attainable, Relevant and Timely.

This method will help you to bring structure and manageability into your financial goals.

Summary

Of course, trading is a risky activity, but there are things you can do to avoid increasing your risk.

Being able to overcome the pitfalls and mistakes when trading Forex outlined above should help you trade in a more structured and positive manner towards your trading goals.

Learning how to trade is necessary if you want to improve your results, so you should take the time and effort to regularly improve your trading knowledge.

Don't forget that a trading strategy with strict money and risk management rules evolve with time, as market conditions, your trading experience, and your capital also change. To best follow your progression, you should keep a trading journal.

Also, before you start your trading day, be sure to be in the right state-of-mind, to read once again your trading plan, and to remember to respect your money and risk management rules.

Don't trade in an impulsive manner and don't do revenge trading – always control your emotions.

Chapter 19 – The Risks of Forex Trading

The Forex markets are some of the most traded in the world, attracting an ever-increasing number of traders.

The main reason why more and more traders flock to the Forex markets is that the barriers to entry to trading currencies are so low. All you need to start trading is a computer, a small amount of capital, an Internet connection to access your online trading platforms, and (most importantly) trading knowledge.

Even though it's pretty easy to start trading with an online Forex trading account, this doesn't mean that it is without risk. As a Forex trader, risk is defined as losing money, there are four cornerstone risks that might make this occur.

Learn more: Take our free Mastering Trading Risk course

#1 The danger of uncontrollable market risk

Market risk, also called systematic risk, represents the risk inherent to the entire market, as opposed to the unsystematic risk that only affects a specific asset, market, sector, geographical region, etc. While unsystematic risk can be reduced with diversification, systematic risk cannot.

Market risk is the most 'useful' kind of risk for a trader

Simply put, market risk in the Forex market is linked to everything that can impact the price of the currency pairs you're trading.

Market risk is the most "useful" kind of risk for a trader – the one you want to have exposure to. Indeed, to make money in the market, you need prices to move around, so you can take advantage of the difference in prices when buying and selling. This is referred to as "market volatility".

Consequently, volatility is what allows you to make profitable trades. It's a risk, as you can lose money if the markets go against you, but it's also because of this that you can make winning trades.

Systemic risks

There are countless systematic risks that can affect prices:

- Inflation, growth, and employment figures, as they can impact Central Bank decisions about monetary policy, especially interest rates.
- Other financial and economic announcements.
- Political events, like elections.
- Strikes, geopolitical conflicts, wars, terrorist attacks, and natural disasters.
- Changes in regulations, legislation, and tax policy.

#2 Liquidity risk

When a market is liquid, this means that it's quite easy and fast to open and close your trading positions at the price you're expecting.

Why? Because there are many buyers and sellers in the market.

Even though the Forex market is one of the most liquid financial markets in the world, there are periods of low liquidity. Especially outside of the American and European trading sessions, or during bank holidays and weekends.

This is an important risk that traders should take into consideration, as this usually means that their cost of trading will increase.

Consider the spreads

Indeed, when brokers face a low liquidity situation, they usually increase the size of their spreads. Remember that a spread is the difference between the selling price and the buying price.

> **Liquidity risk can also be linked to more unpredictable situations**

It's the commission you pay to your broker for its services. Increasing trading costs is a situation that only happens when your broker offers variable spreads, which change depending on the market and trading conditions.

However, you can also look for a broker offering fixed spreads, especially if you're uncertain about how a specific currency pair behaves, or if you intend to use an aggressive and active trading method such as scalping during news releases.

Liquidity risk can also be linked to more unpredictable situations.

> **Did you know?**
>
> When the Swiss central bank (SNB) decided to unpegged the franc and cut interest rates deeper into negative territory, markets were caught off guard. This event strongly impacted volatility and liquidity on all currency pairs linked to the CHF, especially the EUR/CHF.
>
> The wild price movements on the Swiss currency were a true liquidity issue.
>
> Can you guess why?

> Because there were so many stop-loss orders that couldn't be matched by any bid offers. Indeed, Forex traders had no reason to think the CHF would strengthen because the SNB never said anything about its wish to abandon the floor for the EUR/CHF currency pair.

#3 Counterparty risk

In the Forex market, the counterparty is the entity with which you open and close trading positions: your broker.

The main risk here is that your counterparty doesn't pay you, either because it went bankrupt, or because of poor regulatory enforcement.

This risk is quite difficult to measure as an individual trader, so they rely on regulatory bodies.

By using a trustworthy broker that is subject to regulation from a reputable authority, you can be more confident when trading.

> **Expert tip**
>
> Depending on where you're trading from, you should make sure that your broker is regulated by either the Financial Conduct Authority (FCA) in the U.K., the U.S. Securities and Exchange Commission (SEC) in the U.S.A., or the Australian Securities & Investments Commission (ASIC) in Australia.
>
> Following the 15th of January 2015, when the SNB surprised the markets by abandoning the EUR/CHF cap, the importance of managing counterparty risk was highlighted.
>
> Not only should you be sure to work with a licensed and regulated broker, but you should also consider the financial strength of its counterparties, which should also be diversified. You need to know that the liquidity providers your broker works with will be able to survive during extreme market conditions, such as that of January 15th, 2015.

#4 Leverage risk

One of the biggest advantages and risks of Forex trading is leverage.

We've gone through leverage and how traders make mistakes with it earlier in the guide, so we won't repeat that again.

The main point to make here is that leverage amplifies all the other cornerstone risks, for instance:

- If you take on too much market risk without a stop-loss any large losses from sudden movements get leveraged up.
- If a liquidity squeeze forces your trading costs to balloon then that gets leveraged up because the spread is a function of your total position.
- To get unlimited leverage you now have to go overseas, perhaps to a broker in a poorly regulated jurisdiction – this increases your counterparty risk.

The bottom line with leverage is just because it is available to you on a massive scale you don't have to use it.

In summary

There is no such thing as risk-free trading. The four cornerstone risks in Forex trading are:

- Market
- Liquidity
- Counterparty
- Leverage

One of the skills needed when becoming a successful and profitable Forex trader is developing a full appreciation for the risks being taken and how to manage them.

The good news is there are tried and tested risk management strategies, which we went through in an earlier chapter, that can be employed to ensure you are exposed to the risks you want to be and have limited exposure to the ones you don't.

Chapter 20 – Next Steps

We hope this guide has been an informative and helpful introduction to the world of Forex trading.

In it, we have covered many of the basics and some of the more detailed topics related to Forex trading, including

- Why Forex is so popular
- How Forex works
- The products used to trade Forex – spot Forex, CFD and spread bets
- How margin trading works
- The best time of day to trade
- The regulations and protections
- Risk management strategies
- How to form winning Forex strategies
- New Forex trader mistakes

We've even provided three clear worked examples, so the practical side of Forex trading is clear.

Assuming you have a sincere interest in pursuing Forex trading – or at least in learning more about it – we'd like to invite you to join us.

Premium Trading Courses

Learn the skills you need to make money trading the markets with our programme of live courses.

For new traders, we've got the Trading for Beginners Course, for those ready to fast-track their development we've got our Trading Foundations Programme.

Free Resources

We've got lots of seriously insightful free materials: dozens of free on-demand courses, 100+ expert insights, an extensive trading glossary, the MYTS Spread Betting Guide and our market analysis posted on YouTube – subscribe to our channel to get notified when new videos are released.

Expert Community

The MYTS Community is a revolutionary online platform for new and experienced traders looking to share ideas and make profits.

Reflect and commit

We've come to the end of the MYTS Forex Trading Guide. Thank you for taking the time to study it, we hope you found it useful. Take some time to reflect on Forex trading and how you might start approaching the opportunity with the benefit of the information we've provided.

Then, if it is for you, really commit to developing your skills and making it a reality.