The Ultimate Guide to

FOREIGN EXCHANGE FOR BEGINNERS

There are many different types of trading, and foreign exchange trading is both a popular and complicated one. The foreign exchange market is run by a global network of financial institutions and other organizations and is considered de-centralized. For this and other reasons, it is one of the most unique types of market trading.

WHAT IS FOREX TRADING?

In simple terms, forex trading is changing one form of currency into another within an international market. This trading will always involve a currency pair, which means that you'll always be selling one currency while buying a different one.

FOREX PAIRS AND PRICING

In addition to having unique symbols, different currencies are represented by three-letter codes. Generally, the first two letters of these codes stands for the country and the third letter refers to the name of the currency itself. For example, USD stands for the U.S. dollar, while JPY stands for the Japanese yen.

Currencies are traded in pairs. There are four types of forex pairs:

Major Pairs – These are the most frequently traded pairs, comprised of 7 currencies that make up the majority of all trading.

Minor Pairs – These are the less frequently traded pairs that involve currencies outside of the major 7.

Exotics Pairs – These pairs involve one major currency and one currency from a smaller or emerging economy.

Regional Pairs – These pairs are classified by region, such as Scandinavian or Australian.

WHAT DETERMINES THE VALUE OF CURRENCIES?

Currencies and their value fluctuate as often as day to day and are affected by a variety of factors. The final price and value is determined by supply and demand, which reflects factors such as:

Current Interest Rates – How high or low the current interest rates are can directly determine or affect the value of a country's currency. More than anything, unstable rates that fluctuate irregularly will negatively affect a currency's value.

Economic Performance – How a country's economy is currently performing, either independently or as compared with other countries, affects the supply and demand of that country's currency.

Political Events – Local or global political events can affect the value of currencies, called geopolitical risk; how currency is affected is determined by whether the impacts of the events are positive, negative, or yet to be determined.

Future Economic Projections – A country's future economic projections can affect currency more than the present circumstances, especially if future events are expected to have negative impacts on the country.

Expected Currency Performance – Similar to how a country's economy is compared to other countries' and examined independently, currencies and their expected performance (such as inflation) are also examined.

COMPONENTS OF FOREX TRADING

There are a lot of terms that come with information about forex trading related to the various aspect of foreign exchange. While some of the terms and what they represent may be obvious, others can be trickier or more confusing. Common components of forex trading and the terms used to refer to them include:

Markets – Under the umbrella of forex trading are different markets that allow traders or parties to exchange currency in different ways. Each involves its own types of contracts, advantages, and disadvantages.

Interbank Market – International banks and other financial institutions often utilize a smaller number of financial firms, called "dealers." These dealers work behind the scenes and are involved in the majority of forex trading. As a result, this network is often referred to as the "interbank market," although dealers can also be insurance companies, financial firms, etc.

Currency Pairs – Currency can only be traded in pairs, so most trades are categorized into one of four types of forex pairs, also called currency pairs.

Pip – Pip stands for percentage in point or price interest point. It is the measurement unit used to show change in a forex pair. All major currencies except for the Japanese yen are priced to four decimal points, and a pip is one unit of the fourth decimal point. So if the USD in a major pair changes from $1.23462 to $1.23472, the USD has moved 1 pip.

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RISKS OF FOREX TRADING

Like any other type of trading, there are risks in addition to thebenefits of forex trading. These risks vary depending on where the trading parties are located, the trader organizations they use, and more. Government oversight and industry regulation varies by country.

Standardization – Forex instruments are not standardized across the countries or platforms, which creates inherent risk.

Brokerage – Smaller retailers, businesses, and individuals often use similarly small forex brokers and dealers, who can re-quote prices, trade against their own customers, or otherwise cheat customers when safeguards are lax or nonexistent.

To avoid some of these risks, it's best for investors to thoroughly research forex dealers and the market in order to understand existing regulations (or lack thereof), available account protections, and advantages and risks. For example, US and UK dealers tend to offer more oversight, but this doesn't necessarily mean they have the best safeguards against market crises.

Source: The Ultimate Guide to Foreign Exchange for Beginners