The foreign exchange market, or 'forex' market, is becoming increasingly popular in a wide variety of applications. Everyone knows that countries have currencies and they are traded against one another, but few realize the economic significance of these markets in their daily lives, and also there are many myths and rumors surrounding the forex market. In addition, few realize how to get involved in the forex market, and become discouraged when getting the wrong answers.

The forex market by nature is de-centralized because there is no official currency exchange such as for equities or commodities. On some exchanges, such as the CBOT, forex futures are traded as commodity contracts. However there is nothing stopping any bank from trading currency with another bank, with the CBOT, or with retail customers. There are no rules or regulations, and thus, there are many different opinions and packaging surrounding forex markets that are always disputed. The regulators in the US markets, such as the NFA, have stepped into take action involving forex trading, and provide limited rules to follow. It should be noted however that these regulators are involved only when you accept funds from the public. If you are a bank and have no customers, there are no regulations to follow regarding how to trade currency. The regulators are concerned only how you raise money from the public.

Forex strategy

Many people think that to trade currency you need to evaluate a countries economic performance, interest rate policy, and other macro-economic and geopolitical factors. While this no doubt influences the forex market, it is no longer the base of many traders' strategies. A new kind of trading is quickly evolving, based on mathematical analysis of prices, called indicators. If you have ever traded you are probably aware of common indicators such as RSI, MACD, Moving Averages, and Bollinger Bands. But programmers have expanded on this to create their own custom indicators, and some strategies monitor a plethora of indicators creating a super-indicator, which generates buy / sell signals. These strategies are very effective because traders can do an extensive amount of testing before trading live money on them. Finally, when live money is traded and it has a track record, the system can be easily replicated.

One popular platform, Meta Trader, allows anyone to download a demo version of their software which is 100% free. There are nearly 200 brokers in the world using this software platform, so if you find a technique which is working, you can open an account at one of these brokers and implement it with few problems. That means also that a programmer can code a strategy and use it at any of the brokers using Meta Trader platform. Strategies are compiled in files called "Expert Advisors" and can be implemented by clients without programmer or trader intervention. Due to the lack of restrictions and cost, there is a growing international community working on strategies for trading. Of course most of these people are amateurs, but not all of them. And in this case, being an amateur can be an advantage, because you have time to dedicate to the strategy (which requires a high degree of concentration) and possibly money to invest. Also you do not have rules imposed on you by a company or a market; it is a free development environment.

A further extension to these types of strategies and their implementation is seen in technology called Trade Robot. The robot collects buy / sell signals from hundreds of providers, and creates a signal database which includes auditing and tracking. After years of performance data, the robot knows what systems are profitable, and specific trade statistics such as length of trades typically seen by a system, and drawdown ratios. A drawdown is the calculation of loss when an account is losing. No strategy is perfect, even the best are subject to drawdowns, so when the sophisticated investor evaluates a system he is concerned less about absolute returns and more about drawdowns. For example if a system makes 200% with a 50% drawdown that means you are risking 50% of your capital to achieve a 200% return. Usually high yielding systems are very risky and have deep drawdowns, sometimes as much as 20% or more.

What is a pip?

In forex a pip is the smallest unit of measurement. In the EUR/USD 1 pip =$1 on a 10k contract. If the EUR/USD is 1.3448 the 8 represents 8 pips, if the EUR/USD moves from 1.3448 to 1.3449 that would be a 1 pip move. The value of 1 pip depends on the size of contract traded and the base currency, in this case USD. EUR/USD means that 1 Euro = 1.3448 USD. As this rate changes, your open position will have a profit or loss.

How does one get into forex?

Anyone who is new into forex should find someone in the profession who they can trust and can consult with. It is a small world and a trader likely knows a good broker and so on. We do not recommend investing a large amount of money into an account that you will trade, until you have learned the forex market well. There is no reason to drop your account by 50% as a learning curve – open a managed account. There are many successful forex managed programs that you can invest in while you learn. Then when you are ready to trade for yourself (if you want to) then open a mini-account for self-trading and leave money management to the pros. Of course there is a high degree of risk involved in any forex account, but in evaluating the best placement of the capital of a novice investor in the forex arena, it is best placed with someone with experience and track record.

Novice mistakes

If you are new to forex, there are many well produced educational courses you can take which will explain the details of forex trading and investing. However taking one of these courses will not make you an expert, nor will it give you the experience you need to trade as well or better than a seasoned veteran. It is recommended that while you are learning, you work with professionals who can guide you through initial stages of forex. If you don't want to know the details, that's fine too, but you should understand the nature of the market before even investing. Forex is a unique market and there are many features of forex investing that are not available in other markets, such as:

- You need only $1 to open a forex trading account at some brokers
- Many brokers will allow traders as much as 400:1 leverage, meaning with only $1,000 in your account you could trade up to $400,000 in currency!
- Forex is available in many shapes and sizes, there are few standards for trading and software
- The forex market is the most liquid in the world, with over $3 Trillion USD exchanged daily

Accounts and Brokers

A forex trading account is much like other types of accounts you may find at stock brokers or commodity brokers. Usually there are no commissions involved in forex trading, as brokers are compensated through the bid/ask spread. Although brokers offer tight spreads on forex contracts, as little as 3 pips on the EUR/USD for example, with large volume that can add up to substantial revenue for the broker.

A managed account is structurally the same as a self-traded account, except clients sign a Limited Power of Attorney giving a professional money manager access to trade their account. Traders have trading authority only, they cannot deposit and withdraw funds. The account is always in the name of the client, never give funds to a non-registered individual. Any professional would never accept client funds directly, funds are always handled by registered institution.

Common misconceptions

When you are investing in forex funds are not leaving the country! You are trading on the interbank market (or off-exchange market) in either case, brokers settle their aggregate positions end of day in a similar method to stock exchanges, debiting and crediting profit and loss to client accounts. It is not as if your funds are being ‘wired’ out of the country and back.