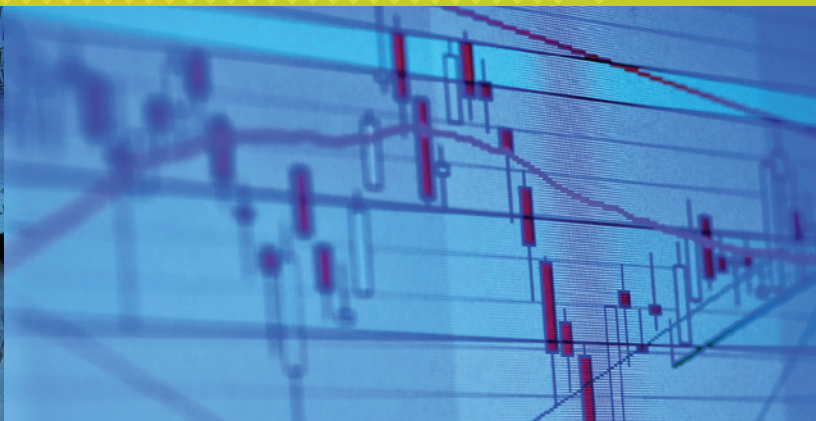


FOREIGN EXCHANGE BASICS





TERMS USED IN FOREX TRADING

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

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

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

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

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

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

While some multinational companies use forex markets to convert foreign profits, others speculate for profit and/or hedge against currency fluctuations.

SIZE AND DEPTH OF THE MARKET

Foreign exchange is by far the largest market in the world, with volume that exceeds commodities, financial futures and stocks. The global OTC foreign currency market represents nearly US \$4 trillion a day in turnover, or some \$84 trillion per month – significantly greater than, and nearly double the NYSE’s dollar volume, according to NYXData and Wiki. Eurodollar OTC trading – just that one currency – accounts for some \$16 trillion per month or more, according to Wiki. Due to this huge volume and liquidity, it would be difficult for any individual or a single firm to move the foreign exchange market.

A true, 24-hour-a-day market, 5 days a week, it begins on Sunday at 5:00 p.m. Eastern time, and goes through Friday at 5:00 p.m. Eastern time. Forex trading opens in Australia, and moves across the globe through Tokyo, London, and New York time zones.

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



THE MAJORS

Seven of the most actively traded currencies are called the majors. Here they are listed with their symbols:

- Euro (EUR)
- U.S. dollar (USD)
- Japanese yen (JPY)
- Swiss franc (CHF)
- British pound (GBP)
- Canadian dollar (CAD)
- Australian dollar (AUD)

These are among the host of exotic currency pairs that PFGBEST offers, listed in alphabetical order along with their symbol:

- Argentine peso (ARS)
- Brazilian real (BRL)
- Chilean peso (CLP)
- Chinese yuan (CNY)
- Columbian peso (COP)
- Czeck koruna (CZK)
- Hong Kong dollar (HKD)
- Hungarian forint (HUF)
- Indonesian rupian (IDR)
- Israeli shekel (ILS)
- Indian rupee (INR)
- South Koran won (KRW)
- Mexican peso (MXN)
- Malaysian ringgit (MYR)
- Philippine dollar (PHP)
- Polish zloty (PLN)
- Romanian leu (RON)
- Russian ruble (RUB)
- Singapore dollar (SGD)
- Slovak koruna (SKK)
- Thai baht (THB)
- New Turkish lira (TRY)
- Taiwan dollar (TWD)
- South African rand (ZAR)

HOW CURRENCIES ARE QUOTED

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

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

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

The pair is quoted in units of the counter currency needed to get one unit of the base currency. So, if the quote EUR/USD is 1.3324¹, it means that 1.3324⁷ U.S. dollars are needed to purchase one Euro. The fourth decimal place (the numeral 4, in our example) is called a “pip.” Pairs are quoted in tenths of a pip, represented here by the numeral 7.

The full exchange rate might not be quoted for both sides of the spread – it would generally be quoted in the last two digits with the tenth of a pip to show eight tenths of a pip difference in price – in our example, 24⁷/25⁵.

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

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WHAT TO KNOW BEFORE YOU TRADE

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

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

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

You will be required to deposit an amount of money – a “security deposit” or “margin” deposit, as a good faith deposit put on hold at your dealer to cover losses. This must occur before you can buy or sell an off-exchange forex contract.

A relatively small amount of money can enable you to hold a forex position worth many times the account value. This is known as leverage. Since leverage allows you to control a much larger amount of currency than the amount of money you have on deposit, it magnifies the percentage amount of your profits and losses.

A margin call is an involuntary liquidation of your positions if the account equity falls below the amount of margin set aside by your dealer. Other firms may charge you for losses that accrue that are greater than the amount on deposit. You should check your agreement with your firm to see if the agreement limits your losses.

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

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