

PART ONE

**The Basics
of FOREX**

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CHAPTER 1**An Introduction
to FOREX**

We assume you are relatively new to FOREX or even new to trading. Perhaps you have dabbled with a demo account or you have some experience in other markets—stocks, futures, or options. This chapter offers a brief overview of FOREX. Our goal is not to give you an extensive primer on FOREX. Several books currently offer that information, such as *Getting Started in Currency Trading*, by Michael Duane Archer (John Wiley & Sons, 2008). The information in this chapter is intended as a brief primer of FOREX trading essentials and mechanics.

Supplementing study with actual practice is the best and fastest way to learn your way around FOREX. If you haven't done so already, we recommend opening a demo account. Consult Chapter 7 for information on brokers with robust demo platforms.

More important to you in the long term is to chart a course of study, personalized to meet your own specific requirements and incorporating the key elements of a successful trading plan. Most new traders shoot from the hip when they begin. Without at least a basic trade plan, they are doomed from the start and thereafter are quick to disparage FOREX trading. Getting started correctly is tremendously important in FOREX. The leverage involved in trading currencies is significant, and small missteps can be fatal. The following GVI snippet is some guidance from a North American trader:

How many traders these days take the time to print a chart and annotate a trading plan? Probably the only ones are guys who are held accountable to themselves, their boards, or managing body.

Even if you are a short term trader, keeping a file with charts and annotations of reasons for entry, trade management, and results is a wonderful teaching tool.

The mechanics of FOREX are not difficult; serious students can learn what they need to know in a week or two of reading and another week or two working with a demo account. The real task is to get started correctly, with a well-thought-out plan. *Forex Essentials in 15 Trades* combines the trading and instructional experiences of three professionals who have a combined century of experience in the market. Following our advice might not make you an instant winner, but it is our hope it will keep you from the fate of most new traders—instant losing.

Along with the text, diagrams, charts, and tables you will find two learning devices that distill our collective experience: “The Inside Scoop” and GVI Snippets, relevant material taken directly from the Global-View web site forums and Learning Center. As a trader you will spend most of your time in front of a computer monitor, watching and studying charts and indicators. “The Inside Scoop” shows you the life behind that screen: the pulsating and vibrating world of professional FOREX trading. Interspersed throughout the book are GVI Snippets from the Global-View web site, providing an inside look and unique perspective you will not find elsewhere. Taken together, they comprise a compendium of advice and maxims that most new traders learn only over many years—if they last so long. They will give you the perspective of experience even if you haven’t yet made a single trade.

THE INSIDE SCOOP (MIKE ARCHER)

I first traded commodity futures at the Denver office of Peavey & Company in 1973. It was a modern office then but would be a dinosaur now. There were a dozen or so chairs for traders, a small open room for high rollers, and a private office in the back for the charmed few. The entire front wall of the office was a large mechanical “clacker board” displaying the open, high, low, and close for 20 different commodities and delivery months. It was called a clacker board because of the sound it made when prices changed. New high prices elicited a green light; new lows, a red light.

In the high rollers’ area sat a grain trader from Eads, Colorado: Charles B. (Charlie) Goodman. For a reason I never knew, Charlie took a liking to me and offered his informal services as a mentor. The techniques I learned—the Goodman Swing Count System and Market Environment (ME) charting—I still use today, although I have developed them much more deeply on my own. His

money management style of “the Belgian dentist”—a very conservative approach to trading—has stood the test of time.

What works for one person might be poison to another—but it is useful to study others’ attitudes and approaches to trading, their money management techniques, and their trading heuristics. If you can find an experienced and successful trader to assist you for the first year of your trading career, you will benefit greatly. A mentor can at the very least keep you from making the many common mistakes of the beginning trader. Most new traders are shown the door quickly because of the mistakes they make. By avoiding them, you greatly enhance your chances of at least staying in the game long enough to learn the game—and eventually succeed. Much of winning in FOREX, as in any business venture, is about staying power.

If a mentor is unavailable, the Global-View forums can act as a useful substitute. A U.S. Global-View member posted:

This [FOREX] forum and better yet, the GVI pro forum are great places to learn different techniques and styles, and learn much of the basics if you pay attention and study.

Most new traders spend too much time and effort on devising a trading method. The hundreds of books on such methods, systems, and technical analysis attest to this misplaced interest. Keep your initial trading method a simple trend-following one. The markets can only go up or down—do not make things more complex than they are in reality. Devote most of your time to managing your money, improving your trading attitude, and getting a true feel for how the markets move and operate: their pace, characteristics, and rhythm.

A successful North American FOREX money manager advises:

Before trading . . . spend time and money on your FX education—it boggles my mind that so many “traders” have never pursued a mentor, developed a method, kept a journal of results, etc. So many beginning traders think for some reason that they can come into a very sophisticated and massively well funded market and compete “off the hip.” They’ve learned to read a few charts, read a book or two, and it’s off to the races. This is a professional career choice . . . much like securities analysts/brokers, doctors, lawyers, and so on.

Does anyone think for a second that these career choices get handed to them? . . . Not in your life! It takes years of study, cost of tuition, and in the case of FX, should come with a mentor or a few mentors of choice, to shortcut the learning curve.

Here is a perspective on the same topic from an Aussie dealer:

To learn any profession, one has to go through a period of learning. This is through various stages, which can be defined as: certificate, diploma, degree, masters, . . . etc.

As an example—How many years (and the hours involved) does it take to obtain a degree in any subject? This is the starting point to trade. From there you continue to learn and refine. . . .

An example—Medical doctors in their training don't get to see anyone before they have their degree—after "x" years of training. Then they have to learn more by practical experience, based on previous knowledge. That is just the basics. Then how long does it take to become a specialist?

Just an analogy, as trading is not as simple as many would like to portray it.

FOREX FIRST STEPS: WHAT IS IT?

FOREX, which stands for FOReign EXchange, is the global trading of currencies. More than \$3.0 trillion in foreign exchange transactions take place each business day, and the volume is increasing steadily. Until the mid-1990s the arena was the domain of large banks (the interbank market), governments, and corporations. Now it is possible for small speculators to trade online with any of a large number of retail FOREX broker-dealers using an online trading platform.

It is important to remember that a currency trade is between two currencies—a pair if one of them is the U.S. dollar (USD) and a cross otherwise—and not a buy or sell of something such as a security (e.g., General Motors) or a commodity (e.g., gold) against the dollar.

The most popular currency pair is the EUR/USD—the Eurozone euro against the U.S. dollar. To be long this pair is to want the EUR to go up and the USD to go down. To be short this pair is to want the USD to go up and the EUR to go down.

There is no central clearinghouse for currency trading as there is for stocks or commodity futures. It is the closest thing there is to a pure laissez-faire market. That cuts both ways: The opportunities are enormous but it is a largely unregulated and often cutthroat enterprise.

In the United States, retail FOREX is partially regulated by the Commodity Futures Trading Commission (CFTC) and the National Futures Association (NFA). But, with no central clearinghouse, regulation is by definition less robust and effective than in stocks or commodity futures. Regulation is largely limited to seeing that retail brokers meet certain

capital requirements and follow good-practice guidelines. Caveat emptor is the watchword in FOREX.

WHY TRADE FOREX?

Despite the risks, the retail market is growing by leaps and bounds. Obviously, many traders have concluded that the opportunities outweigh those risks. Here is a short list of why people are attracted to currency trading.

No commissions. There are typically no clearing fees, no exchange fees, no government fees, and no commissions. FOREX works off a bid/ask spread and the costs are contained therein. Some brokers who use the electronic communications network (ECN) transaction model, however, also may charge a small lot fee.

High liquidity. With an average of over \$3 trillion in transactions daily, it is easy to execute even very large orders in foreign exchange. Online brokers most often offer instantaneous fills on retail orders.

No fixed lot size. The standard lot size in retail FOREX is 100,000 units. Most brokers offer mini-lots of 10,000, and some let you trade as few as 100 units! The variable lot size can be an excellent money management tool for the trader. It also allows the new trader to gradually increase trade size as his or her knowledge and profits rise.

A 24-hour market. There is no opening bell in FOREX! You may trade from late Sunday afternoon (U.S. time) to late Friday evening. You may come and go as you like, and trade for as long a time or as short a time as you wish.

Online access. All retail FOREX is conducted online, via the Internet. You will trade from a broker's trading platform, which typically includes not only real-time prices and the ability to place buy and sell orders but also a variety of trading tools such as charts and indicators. Most brokers allow clients to call in orders by phone if the need arises.

Low margin, high leverage. Perhaps the most attractive element to FOREX trading is the ability to trade leverage ratios of from 10:1 up to 400:1! This means that you may control 100,000 USD with from \$10,000 to as little as \$250. With high leverage, a very small move may result in a 100 percent profit—or loss. Gradually increasing leverage can also be an effective money management tool.

Volatility. The FOREX markets can move quickly and sharply; profits can be large if you are correct in your price forecast.

Variety. There are more than 30 currency pairs and crosses traded, although most of the volume is concentrated in about half of those. Many traders claim individual pairs and crosses have personalities that help them make forecasts. There is enough variety to keep opportunities plentiful, but not so much as to be bewildering and confusing.

Not related to the stock market. Currencies most often move independently of the stock market, although there has been a close correlation during the 2008 financial crisis as equities are used as a measure of risk aversion. From an investment perspective it is said that currency prices are *noncorrelated* with stock prices. For this reason FOREX may be an attractive hedge to a larger stock market account.

Limited regulation. Because FOREX is a global interbank enterprise, regulation is necessarily limited. This, of course, can cut both ways, as mentioned earlier.

No insider trading. It is difficult to get useful inside information on currencies. Even if you did know in advance a key government statistic, the markets are so unpredictable that it is not often easy to foretell which way the market will go after a news release.

Countries with popularly traded currencies include:

- United States
- European Union
- Switzerland
- Great Britain
- Japan
- Canada
- Australia
- New Zealand

FOREX TERMS

Here are the most important FOREX terms. To a large extent, learning the syntax or lingo of FOREX is learning FOREX itself.

Ask price. The price at which the market is prepared to sell a specific currency in a foreign exchange contract or cross currency contract. At this price, the trader can buy the base currency. In

the quotation, the ask price is shown on the right-hand side. For example, in the quote USD/CHF 1.4527/32, the ask price is 1.4532, meaning you can buy one U.S. dollar for 1.4532 Swiss francs.

Base currency. The first currency in a currency pair (for example, USD is the base currency in the currency pair USD/CHF). The rate shows how much one unit of the base currency is worth as measured against the second currency. For example, if the USD/CHF rate equals 1.6215, then one USD is worth CHF 1.6215. In the foreign exchange markets, the U.S. dollar is normally considered the base currency for quotes, meaning that quotes are expressed as a unit of \$1 U.S. per the other currency quoted in the pair. The primary exceptions to this rule are the British pound, the Eurozone euro, and the Australian and New Zealand dollars.

Bid price. The price at which the market is prepared to buy a specific currency in a foreign exchange contract or cross currency contract. At this price, the trader can sell the base currency. It is shown on the left-hand side of the quotation. For example, in the quote USD/CHF 1.4527/32, the bid price is 1.4527, meaning you can sell one U.S. dollar for 1.4527 Swiss francs.

Bid/ask spread. The difference between the bid and ask (offer) price.

Big figure quote. Dealer expression referring to the first few digits of an exchange rate. These digits are often omitted in dealer quotes. For example, a USD/JPY rate might be 117.30/117.35, but would be quoted verbally without the first three digits, that is, as “30/35.”

Closed position. A foreign currency position that no longer exists. The process to close a position is to sell or buy a certain amount of currency to offset an equal amount of the open position. This will square the position.

Correlation to the stock market. At the time of this writing currencies are moving in close correlation with the stock market. This is not always the case, however. Professional traders do watch for changes in correlation as an aid to decision making in placing FX orders. The switch between being correlated and non-correlated happens slowly over longer periods of time.

Counter currency. The second listed currency in a currency pair.

Cross currency pair. A foreign exchange transaction in which one foreign currency is traded against a second foreign currency. For example, EUR/GBP is the euro versus the British pound.

Currency pair. The two currencies that make up a foreign exchange rate, for example, EUR/USD.

Electronic communications network (ECN). A system wherein orders to buy and sell are matched through a network of banks

and/or dealers. *See also* market maker; no dealing desk (NDD) broker.

Flat/square. Refers to a trader on the sidelines with no position.

Foreign exchange (FOREX, FX). The simultaneous buying of one currency and selling of another.

FOREX (FX). Foreign exchange.

Going long. The purchase of a stock, commodity, or currency for investment or speculation.

Going short. The selling of a currency or instrument not owned by the seller.

Leverage. The ratio of the amount used in a transaction to the required security deposit, otherwise known as margin. Leverage is typically quoted as a ratio. For example, 100:1 means one dollar controls one hundred dollars of a currency. A 1 percent move of the currency is equal to a 100 percent gain or loss of margin.

Long position. A position that appreciates in value if market prices increase. When the base currency in the currency pair is bought, the position is said to be long.

Lot. A unit used to measure the amount of the deal. The value of the deal always corresponds to an integer number of lots.

Major currency. Any of the following: Eurozone euro, British pound sterling, Australian dollar, New Zealand dollar, U.S. dollar, Canadian dollar, Swiss franc, Japanese yen. *See also* minor currency.

Margin. The required equity that an investor must deposit to collateralize a position.

Market maker. A dealer who regularly quotes both bid and ask prices and is ready to make a two-sided market for any financial instrument. Most retail FOREX dealers are market makers. A market maker is said to have a dealing desk and is the effective counterparty to your trade.

Minor currency. Any of the currencies between a major currency and an exotic. The South African rand and Swedish krona are minor currencies.

Mundo. A synthetic global currency devised by James L. Bickford, calculated as the average of multiple ISO currency pairs. *See* Michael Archer and James Bickford, *Forex Chartist Companion* (John Wiley & Sons, 2006).

No dealing desk (NDD) broker. Provides a platform to which liquidity providers such as banks can offer prices. Incoming orders are

routed to the best available bid or offer. *See also* market maker; electronic communications network (ECN).

Short position. A position that appreciates in value if the market price decreases. When the base currency in the pair is sold, the position is said to be short.

Trading platform. The online set of tools used to trade FOREX. Trading platforms provide real-time prices of currencies, order entry mechanisms, accounting logs, and a variety of trading tools such as calculators, charts, and indicators.

The Glossary offers a comprehensive FOREX lexicon.

FOREX CALCULATIONS

The calculations in FOREX can be confusing, although they are not inherently difficult. Study will get you only so far; practice is the key. Use an online FOREX calculator to see how the various calculations work, then practice with a demo account from one of the brokers we highlight in Chapter 7. More on calculations used in FOREX is provided in Chapter 2 on money management.

You'll eventually need to be able to make these calculations instantaneously; the FOREX markets move quickly, real-time, and you'll need to concentrate on trading, not calculations. But don't worry if they don't come to you right away.

Most broker trading platforms have FOREX calculators you can use to become familiar with how the various values and units interact.

Remember that a currency transaction is between two currencies, not a single currency and a product as is true in stocks and commodity futures. You may either buy or sell a currency, profiting if it goes up or down. If you buy a currency, you are said to be long and an offsetting transaction is to sell. If you sell a currency, you are said to be short and an offsetting transaction is to buy.

EUR/USD is the symbol for the euro-to-U.S. dollar currency pair. If you buy, you are going long the front or base currency and effectively short the back or counter currency. If you sell, you are going short the base currency and effectively long the counter currency.

The basic calculations you will want to learn are the following:

Leverage and Margin Percent

$$\text{Leverage} = 100 \div \text{Margin Percent}$$

$$\text{Margin Percent} = 100 \div \text{Leverage}$$

Leverage is typically quoted as a ratio of X:1, where 1 is the margin for the position and X is the value of the position. For example, 100:1 means you control 100 times the margin amount. Typically anything under 50:1 is considered low leverage, whereas over 100:1 is very high. New traders should begin with low leverage (e.g., 10:1) and increase by 10:1 units as their confidence increases and until they maximize their money management parameters.

Pips

A pip is typically the smallest increment that any currency pair can move in either direction, up or down. In FOREX, profits and losses are calculated in terms of pips first, dollars second. The pip is very much the basic FOREX value. Some brokers now offer fractional pips on the more popular pairs. The pip is typically \$10 on a 100,000 currency lot, \$1 on a 10,000 lot, and \$25 on a 250,000 “bank” lot.

Profit and Loss

Very basically, profit or loss is price change, which in turn is exit price minus entry price. If the value is positive, you made a profit; if it is negative, you lost.

$$\begin{aligned}\text{Profit in Pips} &= \text{Price Change} \times \text{Pips} \\ \text{Profit in USD} &= \text{Price Change} \times \text{Units Traded}\end{aligned}$$

Trading Units

You will always want to know how many units of a pair you can buy or sell. Again, almost all broker-dealer trading platforms offer this information—but you should know how to calculate it on your own, also.

$$\begin{aligned}\text{Units Available} &= 100 \times \text{Margin Available} \times \text{Rate} \div \text{Current Price} \\ &\quad \times \text{Margin Percent}\end{aligned}$$

If the USD is the base currency:

$$\text{Units Available} = 100 \times \text{Margin Available} \div \text{Margin Percent}$$

Standard trading units are 10,000, 100,000, and 1,000,000.

Margin

$$\begin{aligned} \text{Margin Requirement} &= \text{Current Price} \times \text{Units Traded} \\ &\times \text{Margin Percent} \div 100 \end{aligned}$$

Most retail broker-dealers now limit how much of your total account value may be committed to active trades.

Transaction Cost

In FOREX, cost is a function of the bid/ask spread.

$$\begin{aligned} \text{Spread} &= \text{Ask Price} - \text{Bid Price} \\ \text{Transaction Cost} &= \text{Spread} \times \text{Units Traded} \end{aligned}$$

Typical pip spreads run between one and three pips for active markets such as the EUR/USD and four to five pips for less active markets. You pay the pip spread both when you enter (buy/sell) and when you exit (sell/buy).

Pip spreads may vary widely in fast markets, slow markets, and before and after a news announcement. Market makers use this—in principle at least—to maintain an orderly market.

All broker-dealer platforms automatically calculate these figures. Nevertheless, the complete FOREX trader will want to be able to do them on his or her own. At the minimum it will add confidence to your knowledge of the business—and provide a check against any calculations made on your broker's platform.

A few hours with a demo trading account will be an invaluable tool in becoming familiar with the basic FOREX calculations. A picture or an example is worth a thousand words. We suggest you work with only the most popular pair initially, the EUR/USD. After you have mastered the calculations therein, proceed to the other popular pairs and crosses.

USD/CHF

USD/JPY

GBP/USD

EUR/JPY

EUR/CHF

EUR/GBP

GBP/JPY
GBP/CHF
AUD/USD

Orders

The palette of FOREX orders—to enter a market, protect a trade, and exit a market—is large and varied. Some broker-dealers support their own unique order types, as well. The new trader can manage everything comfortably with three basic order types: market, limit, and stop orders.

Market Orders A market order is an order to buy or sell at the market price. The buy may be to initiate a new position or liquidate a previous sell position. The sell may be to initiate a new position or liquidate a previous buy position. A market order may not be filled at the current price, though, since, like a river, prices are always flowing. Most market makers show you the price you will receive before you execute the order. In quoting, you do not get that price. Large orders and slow, fast, and illiquid (thin) markets affect the price you will receive on a market order.

A buy adds to aggregate demand and pushes prices up, if only slightly; a sell adds to aggregate supply and has the opposite effect. The bid/ask spread in FOREX reflects this, as well as protecting your broker and helping him maintain an orderly book—and make a fair profit by serving you.

Limit Orders A limit order specifies a certain price to execute your order. It may also specify duration—how long you wish to keep the order active. A limit order is filled at your price or better.

Stop-Limit Orders There is also a stop-limit order. You specify a price and also a maximum range beyond that price for which the order can be executed. The advantage of a stop-limit order is that you will get the price you want if that price is reached. The disadvantage is that if prices do not trade in your specified range, your order remains unexecuted. In a fast market, a stop-limit order may be a complete waste of effort; they simply will not be executed.

A suggested rule of thumb: Use market orders in normal markets, and use limit orders for large orders and in fast, slow, and thin markets. A market order in a fast market, such as after the release of a news item, can be

a disaster because of ballooning pip spreads and other dealer-intervention actions.

Time-Based Orders A good till canceled (GTC) order remains active until the trader cancels it.

A good for the day (GFD) order remains in the market for the duration of the trading day. Inasmuch as FOREX is a continuous market, the end of the day must be for a set hour.

Be sure to keep track of all open orders you have in every market. It is your responsibility to cancel them, not the broker's.

Stop Orders A stop order is the terminology used for a limit order that liquidates or offsets an open position.

An automatic trailing stop is offered by several broker-dealers. This raises or lowers your stop by a fixed value as the market goes in the direction of your position, thus protecting some of your profits. You can, of course, mechanically apply trailing stops. They are great in theory, but not quite so great in practice. They work better with some trading methods than with others.

A major debate has raged for years as to whether traders should use stop loss orders in the market or simply keep them to themselves (mental stops), wait for the market to reach that price, and then use a market order. Many traders believe brokers use stops entered in the market to balance their books, a practice referred to as "harvesting stops." Brokers are occasionally accused of running or harvesting stops—moving the data feed specifically to execute the stop order. This does happen; how often is very difficult to say.

Beginners should use stops. Once you have some experience in the market—and if and only if you have good discipline—keep mental stops. It is very easy to ignore a mental stop and hope the market turns back in your favor—and it usually does not. Yes, by using stops you let the broker see your order; and yes, stops may be harvested; and yes, stop fills—especially without limits—may be poor. But we still recommend the new trader use them.

We reiterate: *Never leave a position open without a stop! Yes, brokers will occasionally harvest your stop and, yes, you will occasionally be whipsawed—but neither is as bad as coming back and finding that a nice profit has turned into a large loss. Remember: The markets can do anything, anytime. Don't get lulled to sleep by a slow market. Don't think you are sure what a market will do at any time. From any price you see, it is possible for the next price to be up or down.*

MARKET CONVENTIONS

Following is a summary of common FOREX conventions.

Nomenclature

Currency symbols have evolved over the years and predate the computer era. Over the past few decades, dealers increasingly have come to accept the Society for Worldwide Interbank Financial Telecommunication (SWIFT) codes as a standard, although many older codes remain. The SWIFT foreign currency symbols are the international standard for currency codes established by the International Organization for Standardization (ISO). Each currency symbol has a three-letter code. The ISO 4217 currency codes list is the standard in banking and business all over the world.

Since there is no universal standard of value for currency valuation (e.g., the price of oil or wheat is usually expressed in U.S. dollars), the value of a currency has meaning only when it is expressed in terms of another currency. One wag has said that the FOREX market is the largest barter market in the world.

Selected Currency Codes

USD—U.S. dollar

EUR—Eurozone euro

CHF—Swiss franc

GBP—British pound

JPY—Japanese yen

CAD—Canadian dollar

AUD—Australian dollar

NZD—New Zealand dollar

See Appendix C for additional currency codes. A comprehensive list also is available in the Global-View Learning Center at www.global-view.com/forex-trading-tools/swifta.html.

QUOTING CONVENTIONS

As noted, the value of a currency has meaning only when it is expressed in terms of another currency. Thus the EUR/USD rate is the price of one

euro in terms of U.S. dollars. The quoting convention is that the first symbol indicated (e.g., EUR) is one unit of the currency being measured in terms of the second currency indicated (e.g., USD).

Example: EUR/USD = 1.4535 means one euro is worth \$1.4535.

The markets do not have a consistent rule for how any currency is quoted, including the USD. Thus some currencies are quoted in terms of their USD valuations, while other pairs see the USD quoted as its foreign currency value. Which pair uses which convention has been determined by historical precedent.

Selected Pairs

In some pairs, USD value is calculated in terms of one unit of the opposite currency. Thus as the value rises, the opposite currency gains and the USD weakens; and when the value falls, the USD strengthens.

$$\text{EUR/USD} = 1.4535$$

$$\text{GBP/USD} = 1.9525$$

$$\text{AUD/USD} = 0.9060$$

$$\text{NZD/USD} = 0.7930$$

In other pairs, the opposite currency value is calculated in terms of one USD. Thus as the value rises, the opposite currency weakens and the USD gains; and as the value falls, the USD weakens.

$$\text{USD/JPY} = 107.40$$

$$\text{USD/CHF} = 1.1035$$

$$\text{USD/CAD} = 0.9989$$

Note that increasingly the slash (“/”) between currency symbols is being dropped, because some computer programs don’t know what to do with it and it is unnecessary.

Thus EUR/USD becomes EURUSD.

Crosses

Active markets are also made in cross currency (non-USD) pairs (e.g., the euro against the yen). Quoting rules are the same as for the U.S. dollar pairs. Thus the EUR/JPY is the JPY value of one euro.

Example: EUR/JPY = 107.35 means one euro is worth 107.35 yen.

In this relationship, as the value rises, the euro gains against the yen; and as the value falls, the euro weakens.

ELEMENTS OF A TRADE PLAN

A trade plan may be simple or complex. Its goal is to give you a basic map or guide for your trading activities. By making decisions in your trade plan, you can react quickly to changing market conditions.

Money Management

The authors of this book have a combined experience in the markets of almost 100 years. While we differ individually on a number of issues, we are unanimous on one topic: Money management is the most important aspect of successful trading.

Money management is the art and science of managing your money in the market—both in the aggregate and for individual trades.

Key elements of a good trading plan include:

- Money management parameters.
- Markets to trade.
- Trade objectives and stop-loss amounts.
- Basic trading methods.

Money management is covered in more detail in Chapter 2.

Trading Method

Chess players are familiar with the saying, “Chess is a sea in which a gnat may drink and an elephant may bathe.” Ditto technical analysis. The range of technical analysis methods and systems is simply enormous. There are more than 200 books in print on the subject, and the corpus of material published since technical analysis became popular in the late twentieth century would fill a small-town library. Chapter 3 is a short tour of the technical analysis landscape. Retail traders tend to use technical analysis exclusively, whereas professionals often temper their work with fundamental analysis, discussed in Chapter 4.

As a new trader, you should aim to keep your trading method simple. There is much to learn in FOREX, and you’ll need to find time also for learning the basics of money management, analyzing the markets, making calculations, and executing trades.

Attitude

Fear and greed run the markets. Controlling them is the key to long-term success. Successful FOREX traders seem to share certain attitude characteristics. See Chapter 6 for a comparison of good trader characteristics versus bad trader characteristics.

Heuristic

A heuristic, in simplest form, is a question-and-answer process to get from data to a conclusion. Every chess player worth his salt has an analysis heuristic he uses when it is his turn to make a move. Classical chess games are played with time limits, analogous to the real-time movement of the markets. A heuristic can be an invaluable asset in making sure your trades are in line with your methodology, as a diagnostic tool, and to keep you from straying because of the enormous emotional impact of real-time trading.

A heuristic should be a fairly simple process-based approach to analyzing markets, finding candidate trades, entering a trade, exiting a trade, and diagnosing the trade and/or doing a short postmortem of the trade. We like to think of a trade plan as a process loop in which we can make changes on an evolutionary rather than revolutionary basis.

Chapter 8 introduces author Mike Archer's Snowflake heuristic, including a simple trend-following trading method.

Diagnostics and Postmortem

An important component of any trade plan is a diagnostic loop—analyzing your trades on a daily, weekly, and monthly basis. The simpler your trading method, the easier it is to diagnose problem areas and make midcourse corrections. Do a short postmortem of each trade—win or lose, what went right and what went wrong—shortly after closing it and while it is still fresh in your mind. Then, move on; never dwell on it or gloat.

It is important to briefly analyze each trade you make after it is complete. You may wish to devise a short checklist and see how each trade measures up against the points on that list.

SUMMARY

Before you begin trading, you must first become familiar with the mechanics of FOREX trading. Use the Global-View Learning Center, Global-View

forums, and a demo account, and focus on the order process, basic calculations, and the basic pace and rhythm of the markets.

The elements of your trade plan should work together in harmony. The plan should be simple. As Charlie Goodman would say, "After all, the markets can only go up or down." The trade plan should be designed with a heuristic that allows for all elements of the trade process, including a postmortem and incorporation of incremental changes as needed. FOREX markets move quickly, and the leverage factors of 50:1 to 400:1 require that decisions in real time be made quickly, without undue analysis. Learning the basics correctly is an important first step to achieving this goal.

Recommended Global-View Links

Learning Center: www.global-view.com/forex-education/forex-learning/

FOREX Trading Handbook: www.global-view.com/forex-education/forex-trading-handbook/

SWIFT Codes: www.global-view.com/forex-trading-tools/swfta.html

<http://www.pbookshop.com>