



FOREX BOOK

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What is Forex

Trading in Forex—the foreign currency exchange—is sometimes viewed as pure speculation. The potential for profit and, conversely, loss, are on average higher than in other commodities markets. However, as will be explained below, with Forex trading in general, and iForex in particular, there are means of mitigating potential losses, while maintaining the same opportunity for extremely high profit. The Foreign Exchange is the world's largest financial market, with over \$3 trillion traded daily. By way of comparison, the Forex market is 100 times larger than the New York Stock Exchange, and triple the size of the US Equity and Treasury markets combined. Forex is an over-the-counter market (no central trading arena), meaning that transactions are conducted via telephone or internet by a global, decentralized network of banks, multinational corporations, importers and exporters, brokers and currency traders. This is in contrast to, for example, the NYSE, which is a centralized equities trading location.

Trading on the Forex Market: Basic Concepts

Forex is the buying of one currency and the selling of another concurrently. Typically, the major currencies—the British Pound (GBP), the Euro (EUR), the Japanese Yen (JPY), and the Swiss Franc (CHF)—are traded against the US Dollar (USD). Trade pairs in which the USD is not included are called cross pairs, and occur much less frequently.

The currency pairs are expressed with a base currency as the first part of the pair, followed by the quote currency. (For example, USD/JPY would be the US dollar as the base against the Japanese Yen as the quote.)

Accompanying the currency pair is the quota, or bid/ask price. This is expressed in the following format: EUR/USD: 1.2836 1.2839. The first number in the series represents the bid price, the cost of selling the Euro against the Dollar, or going 'short' on the Euro. The second number is the ask price, the cost of buying the Euro against the dollar, or going 'long' on the Euro. The difference between the bid/ask price is called the pip spread.

A pip is the smallest unit of measure for any currency. In most currencies, this is the fifth digit, or the fourth after the decimal point; in dollars, each pip is equivalent to one-hundredth of a penny. One important exception is the Japanese Yen, in which each pip is the second unit after the decimal point, meaning each pip equals one cent.

Advantages in Trading Forex

High leverage/low margins: Most Forex providers offer traders leverages of 100 to 1. This means that for every \$1000, a trader controls \$100,000 worth of contracts. iForex offers traders leverages as high as 400:1, the highest level available on the market.

There is a very small amount of equity required as collateral for such a relatively large position. At iForex, there is full margin usage, meaning that a position is automatically closed only when losses equal the total available amount in the account, negating the possibility of a negative account balance. This is an important means of keeping any potential losses within a predetermined, manageable budget.

Liquidity: With \$2 Trillion traded daily, Forex is the world's most liquid market. Consequently, buy and sell orders can be filled practically instantaneously.

24-hour trading: The Forex market operates 24 hours a day, from Sunday evening to Friday afternoon EST. As a result, traders can react to any important information immediately, and are not as vulnerable to after-hour loss of value.

No bear market: There is the ability to make the same profit in any market, bullish or bearish. The strength of any particular economy is irrelevant to potential profits.

Low transaction costs: There are no hidden fees or commissions in Forex trading. Providers are paid directly from the pip spread.

Small study sample: Unlike the stock market in which there are thousands of options to choose from, there are only seven major currencies in Forex, and most successful traders limit their focus to three or four.

History of Forex

Today's Forex market began to develop in 1973; however, foreign currency trading has been around since Pharaonic Egypt's advent of coinage, and the ancient Babylonian's usage of paper money. More relevant to today's market however, are the post World War II alterations to the international exchange rate. World War II left the United States an industrial giant unscathed by the war, at least in comparison to the European powers. Worldwide confidence in the dollar made it the reserve currency of choice. To prevent a recurrence of the global depression, the Bretton Woods System, ratified by all the major capitalist countries, pegged international currencies to the dollar, which had its value, in turn, fixed in gold. This led to a system of fixed exchange rates, and the dollar's role as de facto reserve currency was formalized.

This arrangement lasted for the next three decades. In the early seventies, however, deteriorating confidence in the strength of the dollar led to market-driven currency values, and a new system of floating exchange rates took hold. The modern Forex market arose from this new arrangement.

Forex Trading Instruments

Spot market: The most popular of the Forex trading instruments, the spot market deals exclusively with the current price of a financial instrument. A spot deal consists of a bilateral contract based on an agreed exchange rate to be delivered within two business days. The spot market is characterized by a large degree of liquidity and currency fluctuation.

Forward market: Forward trades involve future currency exchanges at a predetermined rate, based on the interest rate differential between the two relevant currencies.

Fundamental Analysis

Fundamental analysis examines economic, political and social indicators to predict the economic health of a nation. Currencies can be viewed as the international representative of national economies; it follows, therefore, that economic health is an important component in currency valuation. The fundamental analyst constructs forecast models based on a myriad of different indicators to predict future currency movement.

This section outlines a number of theories and indicators—as well as political dimensions and monetary considerations—that are important in constructing Forex forecast models.

Fundamental Theories

Purchasing power parity: The absolute purchasing power parity (PPP) theory is based on the “law of one price”, which states that identical goods will have the same price in two countries when the exchange rate is at equilibrium. Price disparities between two identical commodities can be exploited by international arbitrageurs, who capitalize on the imbalance for profit, and in so doing push the market towards equilibrium. In practice, it is difficult to find two countries in which there are competitive markets for an identical product of identical quality, without the added cost of trade barriers, tariffs or transportation costs.

Relative PPP: Relative PPP predicts national inflation rates to determine if particular currencies are over/undervalued. For instance, if the inflation rate is higher in the US vis-à-vis Switzerland, the market will adjust the currency values to reflect the reality. This is, again, an opportunity for arbitrageurs who analyze inflationary indicators in search of profit potential.

Fundamental Indicators

Economic Indicators

The gross domestic product: The gross domestic product (GDP) is the total value of all the goods produced within national borders during a certain time period. The GDP determines the pace at which a national economy is growing or recessing. The equation to determine GDP is: consumption+investment+government spending+ (exports-imports). Consumption is by far the largest component, totaling approximately 2/3 of GDP. Quarterly GDP reports are broken into three announcements—advance, preliminary and final. After the final revision, GDP is not revised again

until the July annual benchmark revisions. These revisions can be quite large, and affect the previous five years of data.

Personal income and personal consumption expenditures report: The personal consumption expenditures report (PCE) is the largest component of GDP. It indicates the change in the market value of all goods and services purchased by consumers.

Personal income is the total value of income received from all sources including workforce compensation, proprietors' income, income from rents, dividends and interest and transfer payments (Social Security, unemployment and welfare). The difference between consumption and income is called the savings rate.

The personal income and consumption report, released at 8:30 EST on the first business day of the month, has become a significant economic indicator. While personal income and savings are not in and of themselves extremely important to financial markets, trends in personal income growth and the size of the savings rate can indicate future consumer spending patterns, which directly affect the GDP.

Trade balance: The balance of trade is the difference between national imports and exports over a certain timeframe. A quarterly trade report provides early clues into net export performance, which is indicative of strengthening competitive positioning, an indicator of coming economic growth. Import reports can help to measure domestic demand and consumer spending patterns, but the lag of this report relative to other consumption indicators renders it somewhat unimportant.

Leading indicators: The leading indicators report is a compendium of previously announced economic indicators: new orders, job claims, money supply, average workweek, building permits and stock prices. Therefore, the report is extremely predictable and of little interest to the market.

Industrial Sector

Industrial production: The index of industrial production gauges the change in the nation's industrial output and measures capacity utilization (an estimate of the percentage of factory capacity being used). The 85% capacity mark is perceived as a key barrier over which inflationary pressures are generated.

Durable goods orders: The durable goods order report measures new orders placed with domestic manufacturers for immediate and future delivery of factory hard goods: products which last for an extended period of time (at least three years). Durable goods data offers insight into demand and business investment, and the durable goods orders report is considered a leading indicator of manufacturing activity, the largest component of industrial production.

Business inventories: The business inventories report includes sales and inventory statistics from all three stages of the manufacturing process (manufacturing, wholesale, and retail). But by the time it is released all three of its sales components and two of its inventory components have already been reported. Because retail inventory is the only new piece of information it contains, the market usually ignores the business inventories report. However, sometimes retail inventories swing enough to change the aggregate inventory profile. This may affect the GDP outlook. When it does, the report can elicit a small market reaction. The aggregate sales figures are dated and they say little about personal consumption. They are actually a good coincident indicator, but the market is far more interested in forward-looking statistics. The inventory-to-sales (I/S) ratio measures the number of months it would take to deplete existing inventory at current sales rates. A relatively low (high) I/S ratio may mean that manufacturers will have to build up (draw down) inventory levels. Depending on the strength of final demand and the degree to which recent inventory changes have been intended or unintended, this can have an effect on the industrial production outlook. Note, that this information is much more useful to market economists than it is to other market participants.

Institute for supply management (ISM): The ISM releases a monthly index of manufacturing conditions compiled from numerous industry reports and surveys. Financial markets are extremely sensitive to unexpected ISM changes, because the index is a good predictor of inflationary pressures; indeed, the Federal Reserve keeps a close watch on the index to help determine interest rate policy.

Construction Data

Housing Starts: Housing starts measure the number of residential units for which construction has begun in the previous month. The housing sector is very interest rate sensitive, and a sudden jump in housing starts usually indicates that interest rates have reached a peak.

Single family home sales: The single family home sales report is a demand side indicator of housing sales. Sales are highly dependent on mortgage rates, and tend to react with a few months lag to rate changes. Sales will usually be highest after a recession, as pent up demand is released.

Inflation Indicators

Producer price index: The producer price index (PPI) measures price changes in the manufacturing sector. There are three broad subcategories within the PPI which are generally used for economic analysis: crude intermediate and finished. The market tracks the finished goods index most closely, as it represents prices of goods ready for sale to the end user. The market places emphasis on the 'core rate' basket, excluding food and electricity, which are quite volatile and might obscure inflationary trends.

Consumer price index: The consumer price index (CPI) measures the average price paid by consumers for a specific basket of goods. The CPI is calculated by averaging the price changes of all the components of the basket in order to determine inflationary trends. It is the benchmark inflation index.

Employment Indicators

The employment report: The employment report is comprised of the household and establishment surveys. The surveys produce non-farm payrolls, average workweek, and average hourly figures. Together, these two surveys make up the employment report, the most timely and broadest indicator of economic activity released each month.

The household survey is primarily used to indicate the unemployment rate. The rate is calculated by dividing the number of unemployed by the number of people in the workforce. The unemployment figure is quite volatile due, in part, to the small sample size of the survey—roughly 60,000 households. It is useful to crosscheck the household survey results with the labor and employment figures to determine whether changes are truly representative.

The establishment survey measures productivity of the workforce. The most important component of the survey—and indeed, in the entire employment report—is non-farm payrolls. Non-farm payrolls measure the number of non-agricultural workers in the national workforce. The monthly changes in payrolls can be extremely volatile from one month to the next. However, aside from large swings and the possibility of rather substantial revisions to previous data, non-farm payrolls offers the most comprehensive and extensive snapshot of the economy.

There are two more important indicators in the employment report that bear mentioning: the average hourly earnings and average workweek figures. The average hourly earnings figure not only offers an indication of personal income growth, and consequently a possible indicator into future spending patterns, it also offers evidence of inflationary pressures. The number of hours worked by the non-agricultural workforce is an important determinant in both industrial production and personal income.

Unit labor cost: Non-farm productivity and costs measures worker productivity in relation to the cost of producing a unit of output. During times of inflationary concern, the unit labor cost index in this report can move the market. If productivity is falling, unit labor costs may be rising faster than hourly earnings, which could lead to unemployment.

Initial jobless claims: The Initial jobless claims report measures the number of filings for state jobless benefits. This report provides a timely, but often misleading, indicator of the direction of the economy. Due to the week-to-week volatility of jobless claims, many analysts track a four week average to get a better picture of the underlying trend. It typically takes a sustained move of at least 30,000 claims to signal a meaningful change in job growth.

Consumer Spending

Retail sales: The retail report extrapolates consumer spending patterns from total receipts from sample stores from different regions and product markets. Data is revised three months back, and changes can be quite substantial. Comprehensive benchmark revisions take place once every five years with the release of the Census of Retail Trade.

Employment Cost Index: The employment cost index (ECI) is a quarterly U.S. Department of Labor report measuring workforce compensation in more than 500 industries across the entire United States, in all states and major metropolitan areas. Like the average hourly earnings report, the ECI can indicate inflationary pressures, as increased production costs are eventually passed on to the consumer.

Consumer sentiment: The consumer confidence index (CCI) measures the confidence consumers have in the economy, presently and in the future. There is a direct correlation between consumer confidence and spending—the future expectations portion of the index is generally viewed as a better indicator of future consumer spending patterns than the current conditions section. The

University of Michigan consumer sentiment index is almost identical to the CCI, but is twice monthly, in a preliminary and final reading.

Auto sales: The auto and truck sales report measures the monthly sales of all domestically produced vehicles. Big ticket sales, such as motor vehicles, are interest rate sensitive, making the motor vehicle sector an important indicator of the state of the business cycle.

Chain store index: The U.S. Retail Chain Store Sales Index tracks spending at major chain stores that fit into the general merchandise, apparel and furniture category based on a representative sample of seven large retailers on a weekly basis. Though the report has little to say about broader consumption patterns, it possesses market importance as an early indicator of consumer spending, particularly during key sales seasons like December and August.

Political Factors

Governmental factors are vital to fundamental analysis. Changes in governmental monetary or fiscal policy—or political crises—will generate changes in the economy, which in turn affects the exchange rate. This is particularly evident in interest rate manipulation.

Interest rates: An interest rate increase adjusts the interest differential in the favor of the representative currency provided that there is no parallel increase in the interest rate of the currency partner. For example, if there is an interest rate hike in the United States and no change in Japanese interest rates, the dollar will strengthen against the Yen. If in England, however, there is a similar interest rate movement, the USD/GBP currency pair will remain unchanged.

Political crises: Political crises constitute the x factor in Forex trading. Unforeseen political turbulence or events can trigger sharp currency movements, leading to a sharp decrease in trade volume. The pip spread can, within seconds, widen by dozens of points. Unlike predictable political events, political crises strike quickly and traders must react quickly to avoid big losses.

Technical Analysis

While fundamental analysis helps illustrate the larger forces affecting the currency market, and long-term prospects for economic health, it has some critical failings. First, the almost limitless amount of factors that can be plugged into a forecast model might force a trader into a perpetual state of analysis, unable to pull the trigger on potential deals. More importantly, however, is fundamental analysis' uselessness in predicting entry and exit points. Technical analysis, on the other hand, ignores fundamental forces, focusing on short-term currency movements to identify trends and determine exactly when and what to buy and sell.

A trend is basically a prolonged price movement in a one direction. An upward trend can be identified by sketching a line beneath a series of lows; a downward trend by tracing a line above a series of highs. Over time, recurring price trends form support and resistance levels, or barriers at the top and bottom of the trading level. It is difficult for currencies to penetrate these levels because, over time, supply/demand has been built up in adequate abundance at both levels—demand at the floor, supply at the ceiling. These levels are obvious positions for buy/sell orders. Once these levels are definitively broken, however, they tend to form the opposite barrier.

Dow Theory

Technical analysis is based on the Dow Theory, which rests on a number of fundamental assumptions:

1. Price is a comprehensive reflection of all market forces. All the fundamental indicators described above almost immediately find expression in market pricing.
2. Price movements are trend followers. There are three types of trends: primary, secondary and daily fluctuations.

Primary trend: A primary trend remains in effect until definitive signals prove otherwise.

Secondary trend: A secondary trend reacts against the primary trend, and is a temporary phenomenon. In a bull market, a secondary trend is called a correction; in a bear market secondary trends are sometimes called reaction rallies. A secondary trend can retrace up to 2/3 (usually 50%) towards the starting point of the trend before resuming its primary course.

Daily fluctuations: There is very little opportunity for forecasting daily fluctuations. Overemphasis on daily fluctuations can easily lead to loss.

3. Primary trends are composed of three stages: accumulation/distribution, run-up/run-down and irrational pessimism/optimism.

Accumulation/distribution: During the first stage, knowledgeable traders buy/sell stocks against consensus.

Run-up/run-down: This is the longest stage of the cycle. The market begins to move, the trend is identified and trend followers jump aboard/bail out.

Irrational pessimism/optimism: Run-up/run-down is the longest stage of the cycle. At some point, investors experience irrational exuberance/despair, and the knowledgeable investor will distribute/buy holdings in anticipation of the start of a new cycle.

4. The volume of trades must confirm the trend. Movement on low volume trades can be attributed to many different ephemeral factors; high volume movements are indicative of the true direction of the market.

Elliott Wave Theory

According to the Elliott Wave Theory, a complete market cycle is composed of eight waves, including five waves in the direction of the trend and three waves against. The upward waves within a bull move are called impulse waves, and the three countertrend waves are called corrective waves.

Corrective waves follow certain rules: the second wave can never retrace more than 100% of the first wave; the third wave is never the shortest in an impulse sequence, and often the longest; and the fourth wave can never enter into the price range of the first wave.

Extensions: In any five-wave sequence, a tendency exists for one of the three impulse subwaves to extend in an elongated movement, usually with internal subdivisions, which can sometimes have nearly the same amplitude and duration as the larger waves. Extensions can provide a useful guide to the length of future waves.

Failures: Failures occur when the extreme in the fifth wave fails to exceed the extreme in the third. This signals a weakness in the underlying trend, and a sharp reversal usually follows.

Charts

Price fields: Technical traders base actions on price and volume analysis. The fields, which define a security's price and volume, are explained below.

Open: The price of the first trade during the period.

Close: The last price that the security traded during the period.

High: The highest price that the security traded during the period.

Low: The lowest price a security traded during the period.

Volume: The number of shares (or contracts) traded during the period.

Line chart: A line chart plots single prices for a select period. The daily chart, for instance, generally illustrates the daily closing prices. The obvious problem with the daily chart is its inability to show intra-daily price activity.

Bar chart: The bar chart is the most widely used Forex chart. Each bar represents a certain time period, with the timeframe's high and low represented by the upper and lower boundary of the bar. A small line extends to the left and right of the bar, representing the opening and closing prices of the period, respectively. The closing horizontal line of one period will always be at the same level as the open of the next, forming a price continuum.

Candlestick chart: The candlestick chart is closely related to the bar chart. It also illustrates the high, low, open and close of each period. The opening and closing prices form the rectangular 'body' of the candlestick. Extending from the upper and lower sides of the body are two legs, the boundaries of each representing the high and low of the period. If the close is lower than the open, the body will be shaded; if the close is higher than the open, the body is left blank.

Chart Patterns

Currency valuation moves in trends, and these trends do not last forever. When a particular commodity experiences a countertrend, it usually is not an instantaneous phenomenon. Instead, prices decelerate, pause and reverse. These phases occur as investors form new expectations and, in doing so, shift supply/demand lines. The psychology underlining the changing of expectations often causes price patterns to emerge that are remarkably similar to one another.

Head and shoulders: The head-and-shoulders price pattern is the most reliable and well known chart pattern. It gets its name from its resemblance to a head in the middle of two shoulders. A first upward surge is followed by a secondary trend, after which a larger upward trend propels prices up past the first shoulder. After this new high, or the head, the decline begins. A second shoulder is created as bulls try to push prices higher, ultimately failing. Confirmation of a downtrend (upturn in a reverse head and shoulders) is confirmed when the neckline is penetrated.

Rounding tops and bottoms: Rounding tops/bottoms occur as expectations gradually shift between bullish and bearish.

Triangles: As the range between high and low narrows a triangle is created by drawing trend-lines above the highs and below the lows. A symmetrical triangle occurs when prices are making lower highs and higher lows. An ascending triangle occurs when there are higher lows and consistent highs, usually due to a resistance level. A descending triangle occurs when there are lower highs and consistent lows, usually due to a support level. Ascending and descending triangles often lead to breakouts, in the direction of the trend.

Double tops and bottoms: The double tops is a pattern formed when prices rise to a resistance level, falls, and then returns to the line at a lower volume level. A double top usually marks the beginning of a downtrend. The phenomenon is the same for double bottoms, in reverse.

Statistic Tools

Simple moving average: The simple moving average (SMA) calculates the average currency value over a select period of time (The previous 14-21 days are most common). The SMA eliminates the noise of daily fluctuations, which makes price trends and reversals easier to identify.

Moving average convergence divergence (MACD): Is the average of two cycles, a short exponential moving average and a long exponential moving average. The signal line represents the MACD over

Bollinger bands: Bollinger bands are two lines a standard deviation above and below the moving average. The Bollinger bands adjust automatically to changes in volatility, moving closer to the average during less volatile periods, further away during times of increased volatility. A tightening of the bands indicates that volatility will probably begin to increase. If the moving average moves close to the bottom Bollinger band it means the currency is being oversold, and overbought if it moves close to the top band.

Fibonacci retracement: Traders who use the Fibonacci retracement method believe that support and resistance levels can be found at key Fibonacci points. These points are located by sketching trendlines at the two extreme levels, high and low, and then dividing the vertical difference by key Fibonacci ratios—50%, 61.8% and 38.2%.

Gann fan: The Gann fan is a set of angles which define potential support and resistance point. The ideal relationship between time and price would follow the 45% line from the center of the Gann fan. In total there are eight lines extending from the base of the fan; after one line is broken, the next becomes a new support/resistance barrier.

Momentum: momentum measures the rate at which prices are falling or rising. Speculators will take a long/short position on a position exhibiting accelerated momentum, in the hope that it will continue on its path. This is a short-term method of trading, and is quite risky.

Relative Strength Index (RSI): The RSI is calculated by averaging the highs of a certain time period, averaging the lows, and then dividing the average high number by the average low number. This relative strength is put into the RSI, producing an oscillator that measures price movements on a scale between 0-100. When a price reaches the level of 30 or 70, it means it is being oversold or overbought, respectively.

Stochastic oscillator: The Stochastic oscillator illustrates the current close relative to the high-low range over a set period. The figures are plotted on a graph, with y axis values 0-100. If the Stochastic meter dips beneath 20, the commodity is considered to be oversold, overbought if it surges above 80.

Glossary

Account - Record of all transactions.

Account Balance - Amount of money in an account.

Appreciation - A currency is said to appreciate when price rises in response to market demand; an increase in the value of an asset.

Arbitrage - Taking advantage of countervailing prices in different markets by the purchase or sale of an instrument and simultaneous taking of an equal and opposite position in a related market to profit from small price differentials.

Ask, Offer - The price, or rate, that a willing seller is prepared to sell at.

Ausie - The Australian Dollar

Back Office - The departments and processes related to the settlement of financial transactions (i.e. written confirmation and settlement of trades, record keeping.)

Balance of Payments - A record of a nation's claims of transactions with the rest of the world over a particular time period. These include merchandise, services and capital flows.

Balance of Trade - The value of a country's exports minus its imports.

Bar Chart - A type of chart which consists of four significant points: the high and the low prices, which form the vertical bar, the opening price, which is marked with a little horizontal line to the left of the bar, and the closing price, which is marked with a little horizontal line of the right of the bar.

Base Currency - The currency in which an investor or issuer maintains its book of accounts; the currency that other currencies are quoted against. In the forex market, the US Dollar is normally considered the `base` currency for quotes, meaning that quotes are expressed as a unit of \$1 USD per the other currency quoted in the pair.

Basis Point - One hundredth of a percent.

Bear - An investor who believes that prices/the market will decline.

Bear Market - A market distinguished by a prolonged period of declining prices accompanied with widespread pessimism.

BID - The price that a buyer is prepared to purchase at; the price offered for a currency.

Big Figure - Dealer phrase referring to the first few digits of an exchange rate. These digits rarely change in normal market fluctuations, and therefore are omitted in dealer quotes, especially in times of high market activity. For example, a USD/Yen rate might be 107 ,30/107.35 but would be quoted verbally without the first three digits i.e. "30/35."

Bonds - Bonds are tradable instruments (debt securities) which are issued by a borrower to raise capital. They pay either fixed or floating interest, known as the coupon. As interest rates fall, bond prices rise and vice versa.

Bretton Woods Agreement of 1944 - An agreement that established fixed foreign exchange rates for major currencies, provided for central bank intervention in the currency markets, and pegged the price of gold at US \$35 per ounce. The agreement lasted until 1971, when President Nixon overturned the Bretton Woods agreement and established a floating exchange rate for the major currencies.

Broker - An individual, or firm, that acts as an intermediary, putting together buyers and sellers usually for a fee or commission. In contrast, a `dealer` commits capital and takes one side of a position, hoping to earn a spread (profit) by closing out the position in a subsequent trade with another party .

Buba - Bundesbank, Central Bank of Germany

Bull - An investor who believes that prices/the market will rise.

Bull Market - A market distinguished by a prolonged period of rising prices. (Opposite of bear market)

Cable - Trader jargon for the British Pound Sterling referring to the Sterling/US Dollar exchange rate. Term began due to the fact that the rate was originally transmitted via a transatlantic cable starting in the mid 1800`s.

Candlestick Chart - A chart that indicates the trading range for the day as well as the opening and closing price. If the open price is higher than the close price, the rectangle between the open and close price is shaded. If the close price is higher than the open price, that area of the chart is not shaded.

Capital Markets - Markets for medium to long-term investment (usually over 1 year). These tradable instruments are more international than the 'money market' (i.e. Government Bonds and Eurobond).

Central Bank - A government or quasi-governmental organization that manages a country's monetary policy and prints a nation's currency. For example, the US central bank is the Federal Reserve, others include the ECB, BOE, BOJ .

Chartist - An individual who uses charts and graphs and interprets historical data to find trends and predict future movements. Also referred to as Technical Trader .

Clearing - The process of settling a trade.

Closed Position - Exposures in Foreign Currencies that no longer exist. 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.

Commission - A transaction fee charged by a broker.

Confirmation - A document exchanged by counterparts to a transaction that confirms the terms of said transaction.

Contract - The standard unit of trading.

Counter Party - The participant, either a bank or customer, with whom the financial transaction is made.

Cross Rate - An exchange rate between two currencies. The cross rate is said to be non-standard in the country where the currency pair is quoted. For example, in the US, a GBP/CHF quote would be considered a cross rate, whereas in the UK or Switzerland it would be one of the primary currency pairs traded .

Currency - Any form of money issued by a government or central bank and used as legal tender and a basis for trade.

Currency Pair - The two currencies that make up a foreign exchange rate. For Example, EUR/USD.

Currency Risk - The risk of incurring losses resulting from an adverse change in exchange rates.

Day Trading - Opening and closing the same position or positions within the same trading session.

Dealer - An individual or firm that acts as a principal or counterpart to a transaction. Principals take one side of a position, hoping to earn a spread (profit) by closing out the position in a subsequent trade with another party. In contrast, a broker is an individual or firm that acts as an intermediary, putting together buyers and sellers for a fee or commission.

Deficit - A negative balance of trade or payments.

Delivery - An actual delivery where both sides transfer possession of the currencies traded.

Deposit - The borrowing and lending of cash. The rate that money is borrowed/lent at is known as the deposit rate (or depo rate). Certificates of Deposit (CD`S) are also tradable instruments.

Depreciation - A decline in the value of a currency due to market forces.

Derivative - A contract that changes in value in relation to the price movements of a related or underlying security, future or other physical instrument. An Option is the most common derivative instrument.

Devaluation - The deliberate downward adjustment of a currency's price, normally by official announcement.

ECB - European Central Bank - The Central Bank for the European Monetary Union.

Economic Indicator - A statistic that indicates current economic growth and stability issued by the government or a non-government institution (i.e. Gross Domestic Product (GDP), Employment Rates, Trade Deficits, Industrial Production, and Business Inventories).

EMU - European Monetary Union - The principal goal of the EMU is to establish a single European currency called the Euro, which will officially replace the national currencies of the member EU countries in 2002. On January 1, 1999 the transitional phase to introduce the Euro began. The Euro now exists as a banking currency and paper financial transactions and foreign exchange are made in Euros. This transition period will last for three years, at which time Euro notes and coins will enter circulation. On July 1, 2002, only Euros will be legal tender for EMU participants, the national currencies of the member countries will cease to exist. The current members of the EMU are Germany, France, Belgium, Luxembourg, Austria, Finland, Ireland, the Netherlands, Italy, Spain and Portugal.

End Of Day (Mark-to-Market) - Traders account for their positions in two ways: accrual or mark-to-market. An accrual system accounts only for cash flows when they occur, hence, it only shows a profit or loss when realized. The mark-to-market method values the trader's book at the end of each working day using the closing market rates or revaluation rates. Any profit or loss is booked and the trader will start the next day with a net position.

Euro - The currency of the European Monetary Union (EMU), which replaced the European Currency Unit (ECU).

Execution Date - The date on which a trade occurs.

Fed - Federal Reserve - The Central Bank for the United States.

Fixed Exchange Rate (Representative Rate) - An official exchange rate set by monetary authorities for one or more currencies. In practice, even fixed exchange rates fluctuate between definite upper and lower bands, leading to intervention.

Flat (Square, Balanced) - To be neither long nor short is the same as to be flat or square. One would have a flat book if he has no positions or if all the positions cancel each other out.

FOMC - Federal Open Market Committee - The Federal Reserve monetary committee.

Forex - Foreign Exchange - The simultaneous buying of one currency and selling of another in an over-the-counter market. Most major FX is quoted against the US Dollar.

Forward - The pre-specified exchange rate for a foreign exchange contract settling at some agreed future date, based upon the interest rate differential between the two currencies involved.

Forward Points - The pips added to or subtracted from the current exchange rate to calculate a forward price.

FRA - Forward Rate Agreements – FRA's are transactions that allow one to borrow/lend at a stated interest rate over a specific time period in the future.

Front and Back Office - The front office usually comprises of the trading room and other main business activities.

Fundamental Analysis - Analysis of economic and political information with the objective of determining future movements in a financial market.

Futures Contract - An obligation to exchange a good or instrument at a set price on a future date. The primary difference between a Future and a Forward is that Futures are typically traded over an exchange (Exchange- Traded Contracts - ETC), versus forwards, which are considered Over The Counter (OTC) contracts. An OTC is any contract NOT traded on an exchange.

G5 - The five leading industrial countries, being US, Germany, Japan, France, UK.

G7 - The seven leading industrial countries, being US, Germany, Japan, France, UK, Canada, Italy.

GDP - Gross Domestic Product - Total value of a country's output, income or expenditure produced within the country's physical borders.

GNP - Gross National Product - Gross domestic product plus income earned from investment or work abroad.

GTC - Good-Till-Cancelled - An order left with a Dealer to buy or sell at a fixed price. The GTC will remain in place until executed or cancelled.

Hedge - A position or combination of positions that reduces the risk of your primary position.

High/Low - Usually the highest traded price and the lowest traded price for the underlying instrument for the current trading day.

IMF - International Monetary Fund - The IMF is an international organization of 184 member countries. It was established to promote international monetary cooperation, exchange stability, and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment.

Inflation - An economic condition where there is an increase in the price of consumer goods, thereby eroding purchasing power.

Initial Margin - The initial deposit of collateral required to enter into a position as a guarantee on future performance.

Interbank Rates - The Foreign Exchange rates at which large international banks quote other large international banks .

Intervention - Action by a central bank to affect the value of its currency by entering the market. Concerted intervention refers to action by a number of central banks to control exchange rates.

IRS - Interest Rate Swaps - An exchange of two debt obligations that have different payment streams. The transaction usually exchanges two parallel loans; one fixed the other floating.

Kiwi - The New-Zealand Dollar.

Leading Indicators - Economic variables that are considered to predict future economic activity (i.e. Unemployment, Consumer Price Index, Producer Price Index, Retail Sales, Personal Income, Prime Rate, Discount Rate, and Federal Funds Rate.)

Leverage - Also called margin. The ratio of the amount used in a transaction to the required security deposit.

Libor - London InterBank Offered Rate - The London Inter-Bank Offered Rate. Large international banks use LIBOR when borrowing from another bank .

Limit Order - An order with restrictions on the maximum price to be paid or the minimum price to be received. As an example, if the current price of USD/YEN is 117.00/05, then a limit order to buy USD would be at a price below 102. (ie 116.50)

Liquidation - The closing of an existing position through the execution of an offsetting transaction.

Liquidity - The ability of a market to accept large transaction with minimal to no impact on price stability.

Long - A position to purchase more of an instrument than is sold, hence, an appreciation in value if market prices increase.

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

Loonie - The Canadian Dollar.

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

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.

Market Order - An order to buy/sell at the best price available when the order reaches the market.

Money Markets - Refers to investments that are short-term (i.e. under one year) and whose participants include banks and other financial institutions. Examples include Deposits, Certificates of Deposit, Repurchase Agreements, Overnight Index Swaps and Commercial Paper. Short-term investments are safe and highly liquid.

MPC - Monetary Policy Committee - A committee of the central bank that is responsible for the monetary policy decisions.

OCO - One Cancels the Other - A contingent orders where the execution of one part of the order automatically cancels the other part.

Open order - An order that will be executed when a market moves to its designated price. Normally associated with Good 'til Cancelled Orders.

Open Position - An active trade with corresponding unrealized P&L, which has not been offset by an equal and opposite deal.

Options - An agreement that allows the holder to have the option to buy/sell a specific security at a certain price within a certain time. Two types of options – call and put. A call is the right to buy while a put is the right to sell. One can write or buy call and put options.

Order - An order is an instruction, from a client to a broker to trade. An order can be placed at a specific price or at the market price. Also, it can be good until filled or until close of business.

Overnight Position - A trade that remains open until the next business day.

Points. Pips - The term used in currency market to represent the smallest incremental move an exchange rate can make. Depending on context, normally one basis point (0.0001 in the case of EUR/USD, GBD/USD, USD/CHF and .01 in the case of USD/JPY).

Position - A position is a trading view expressed by buying or selling. It can refer to the amount of a currency either owned or owed by an investor.

Premium - In the currency markets, it is the amount of points added to the spot price to determine a forward or futures price.

Profit/Loss (P/L) - The actual "realized" gain or loss resulting from trading activities on Closed Positions, plus the theoretical "unrealized" gain or loss on Open Positions that have been Mark-to-Market.

Quote - An indicative market price; shows the highest bid and/or lowest ask price available on a security at any given time.

Rally - A recovery in price after a period of decline.

Range - The difference between the highest and lowest price of a future recorded during a given trading session.

Rate - The price of one currency in terms of another.

Repo - Re-purchase - This type of trade involves the sale and later re-purchase of an instrument, at a specified time and date. Occurs in the short-term money market.

Resistance - A term used in technical analysis indicating a specific price level at which a currency will have the inability to cross above. Recurring failure for the price to move above that point produces a pattern that can usually be shaped by a straight line.

Risk Management - To hedge one's risk they will employ financial analysis and trading techniques.

Roll-Over - Process whereby the settlement of a deal is rolled forward to another value date. The cost of this process is based on the interest rate differential of the two currencies.

Settlement - The process by which a trade is entered into the books and records of the counterparts to a transaction. The settlement of currency trades may or may not involve the actual physical exchange of one currency for another.

Short - To go 'short' is to have sold an instrument without actually owning it, and to hold a short position with expectations that the price will decline so it can be bought back in the future at a profit.

Short Position - An investment position that benefits from a decline in market price. When the base currency in the pair is sold, the position is said to be short.

Spot - A transaction that occurs immediately, but the funds will usually change hands within two days after deal is struck.

Spot Price - The current market price. Settlement of spot transactions usually occurs within two business days.

Spread - The difference between the bid and offer (ask) prices; used to measure market liquidity. Narrower spreads usually signify high liquidity.

Stop Loss Order - An order to buy/sell at an agreed price. One could also have a pre-arranged stop order, whereby an open position is automatically liquidated when a specified price is reached or passed.

Support Levels - A technique used in technical analysis that indicates a specific price ceiling and floor at which a given exchange rate will automatically correct itself. Opposite of resistance.

Swap - A currency swap is the simultaneous sale and purchase of the same amount of a given currency at a forward exchange rate.

Technical Analysis - An effort to forecast prices by analyzing market data, i.e. historical price trends and averages, volumes, open interest, etc .

Tick - A minimum change in price, up or down.

Tomorrow Next (Tom/Next) - Simultaneous buying and selling of a currency for delivery the following day.

US Prime Rate - The interest rate at which US banks will lend to their prime corporate customers.

Value Date - The date on which counterparts to a financial transaction agree to settle their respective obligations, i.e., exchanging payments. For spot currency transactions, the value date is normally two business days forward. Also known as maturity date.

Volatility - A statistical measure of a market or a security's price movements over time and is calculated by using standard deviation. Associated with high volatility is a high degree of risk.

Volume - The number, or value, of securities traded during a specific period.