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4th Edition

Currency Trading

for
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Understand buying and selling different currency pairs

Discover how to make money from the foreign exchange market

Invest in currency ETFs, futures, and more

Paul Mladjenovic

Author of the bestselling
Stock Investing For Dummies

Kathleen Brooks
Brian Dolan



Currency Trading

4th Edition

**by Paul Mladjenovic, Kathleen Brooks,
and Brian Dolan**

**for
dummies®**
A Wiley Brand

Currency Trading For Dummies®, 4th Edition

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Table of Contents

[Cover](#)

[Title Page](#)

[Copyright](#)

[Introduction](#)

[About This Book](#)

[Foolish Assumptions](#)

[Icons Used in This Book](#)

[Beyond the Book](#)

[Where to Go from Here](#)

[**Part 1: Getting Started with Currency Trading**](#)

[**Chapter 1: Currency Trading 101**](#)

[What Is Currency Trading?](#)

[What Affects Currency Rates?](#)

[Developing a Trading Plan](#)

[Executing the Trading Plan from Start to Finish](#)

Chapter 2: What Is the Forex Market?

[Getting Inside the Numbers](#)

[Around the World in a Trading Day](#)

[Looking at Currencies and Other Financial Markets](#)

[Getting Started with a Practice Account](#)

Chapter 3: Who Trades Currencies? Meet the Players

[The Interbank Market Is “the Market”](#)

[Hedgers and Financial Investors](#)

[Speculators: Running the Forex Show](#)

[Governments and Central Banks](#)

Chapter 4: The Mechanics of Currency Trading

[Buying and Selling Simultaneously](#)

[Looking at Profit and Loss](#)

[Understanding Rollovers and Interest Rates](#)

[Checking Out Currency Prices](#)

[Executing a Trade](#)

Part 2: Data and Details You Can Use to Trade Currencies

Chapter 5: Looking at the Big Picture

[Currencies and Interest Rates](#)

[Monetary Policy 101](#)

[Official Currency Policies and Rhetoric](#)

[Geopolitical Risks and Events](#)

Chapter 6: Cutting the Fog with Technical Analysis

[The Philosophy of Technical Analysis](#)

[The Art of Technical Analysis](#)

[The Science of Technical Analysis](#)

Chapter 7: Getting Down and Dirty with Fundamental Data

[Finding the Data](#)

[Economics 101 for Currency Traders: Making Sense of Economic Data](#)

[Assessing Economic Data Reports from a Trading Perspective](#)

[Market-Moving Economic Data Reports from the United States](#)

[Major International Data Reports](#)

Chapter 8: Getting to Know the Major Currency Pairs

[The Big Dollar: EUR/USD](#)

[East Meets West: USD/JPY](#)

[The Other Majors: Sterling and Aussie](#)

[Understanding Forex Positioning Data](#)

Chapter 9: Minor Currency Pairs and Cross-Currency Trading

[Trading the Minor Pairs](#)

[Trading the Scandies: SEK, NOK, and DKK](#)

[Checking Out Cross-Currency Pairs](#)

Part 3: Executing a Trading Plan

Chapter 10: Pulling the Trigger

[Getting into the Position](#)

[Making the Trade Correctly](#)

Chapter 11: Managing the Trade

[Monitoring the Market While Your Trade Is Active](#)

[Updating Your Trade Plan as Time Marches On](#)

[Updating Order Levels as Prices Progress](#)

Chapter 12: Tax Considerations

[Determining Whether You Have Trader Tax Status](#)

[Understanding Ordinary Income, Capital Gains, and Capital Losses](#)

[Buckling Down and Paying Taxes to the IRS](#)

[Surveying Tax Specifics for Different Types of Currency-Related Activities](#)

[Taking Advantage of Tax-Advantaged Retirement Investing](#)

[Seeking Some Tax Resources](#)

Part 4: Forex Alternatives

Chapter 13: Currency Exchange-Traded Funds

[Defining Currency ETFs](#)

[Picking Out the Pros of Currency ETFs versus Other Currency Vehicles](#)

[Comparing U.S. Dollar Bullish and Bearish ETFs](#)

[Examining Other Currency ETFs](#)

[Choosing Currency ETFs: Hedged or Unhedged?](#)

[Studying Some Currency ETF Resources](#)

Chapter 14: Currency Futures

[Defining Currency Futures](#)

[Comparing Currency Trading and Currency Futures](#)

[Focusing on the Fundamentals of Currency Futures Contracts](#)

[Surveying Basic Futures Trading Strategies](#)

[Reading Currency Futures Quotes](#)

[Sizing Up E-Minis and E-Micros](#)

[Checking Out Futures Trading Resources and Brokers](#)

Chapter 15: Currency Options

[Introducing the Basics of Options](#)

[Buying a Call Option for Big Gains](#)

[Writing a Call Option to Generate Income](#)

[Using a Call Option for Safety or Hedging](#)

[Picking Apart Put Options](#)

[Considering Some Combination Trades](#)

[Breaking Down the Mechanics of Making Options Trades](#)

[Getting a Few Golden Rules for Options Beginners](#)

[Trying Options Tutorials and Resources](#)

Chapter 16: Trading Cryptocurrencies

[Describing Cryptocurrencies](#)

[Considering the Main Benefits and Issues of Cryptocurrencies](#)

[It's Your Choice: Participating in the Cryptocurrency World in Three Ways](#)

[Looking at Leading Cryptocurrencies](#)

[Taking the First Steps to Buying Cryptocurrencies](#)

[Examining Cryptocurrency ETFs](#)

[Getting a Few Golden Rules about Cryptocurrencies](#)

[Digging into Cryptocurrency Resources](#)

Part 5: The Part of Tens

Chapter 17: Ten Habits of Successful Currency Traders

[Trading with a Plan](#)

[Anticipating Event Outcomes](#)

[Staying Flexible](#)

[Being Prepared for Trading](#)

[Keeping Technically Alert](#)

[Going with the Flow \(Trading the Range\)](#)

[Focusing on a Few Pairs](#)

[Protecting Profits](#)

[Trading with Stop Losses](#)

[Watching Other Markets](#)

Chapter 18: Ten Rules of Risk Management

[Trade with Stop-Loss Orders](#)

[Leverage to a Minimum](#)

[Trade with a Plan](#)

[Stay on Top of the Market](#)

[Look for the Right Opportunities](#)

[Step Back from the Market](#)

[Take Profit Regularly](#)

[Understand Currency-Pair Selection](#)

[Double-Check for Accuracy](#)

[Take Money Out of Your Trading Account](#)

Chapter 19: Ten Great Resources for Currency Trading

[Technical Analysis of the Financial Markets](#)

[Japanese Candlestick Charting Techniques](#)

[Elliott Wave Principle](#)

[Technical Analysis For Dummies](#)

[The Book of Five Rings](#)

[Market Wizards: Interviews with Top Traders](#)

[FOREX.com](#)

[Zero Hedge](#)

[BabyPips.com](#)

[Forex Factory](#)

Chapter 20: Ten (Or So) Golden Rules for Currency Trading Beginners

[Read, Read, Read](#)

[Simulate Trading First](#)

[Start Small](#)

[Keep a Ceiling on Your Total Speculating](#)

[Be Diversified](#)

[Have a Rule on Profits \(and Losses!\)](#)

[Analyze the Trade That Went Bad](#)

[Learn from Others](#)

[Recognize That History May Not Repeat, but It Does Rhyme](#)

[Specialize If Possible \(In Other Words, Focus!\)](#)

[Know That Successful Trading Isn't Just What You Do but How You Do It](#)

[Finally, Don't Stop Educating Yourself](#)

Chapter 21: Ten Alternatives to Currencies

[Gold](#)

[Silver](#)

[Cryptocurrencies](#)

[Common Stocks](#)

[The “I” Bond](#)

[Commodities](#)

[Mutual Funds](#)

[Country Exchange-Traded Funds](#)

[Collectibles](#)

[Real Estate Investment Trusts](#)

Appendix: Trading Strategies

[What’s Your Sign? Determining Your Trader Type](#)

[Looking at Trading Strategies Based on Trader Type](#)

Index

About the Authors

Advertisement Page

Connect with Dummies

End User License Agreement

List of Tables

Chapter 4

[TABLE 4-1 The Major U.S. Dollar Currency Pairs](#)

[TABLE 4-2 Euro Crosses](#)

[TABLE 4-3 Yen Crosses](#)

[TABLE 4-4 Sterling Crosses](#)

[TABLE 4-5 Other Crosses](#)

Chapter 13

[TABLE 13-1 Available Currency Exchange-Traded Funds](#)

[TABLE 13-2 Hedged Currency ETFs](#)

Chapter 14

[TABLE 14-1 Currency Futures Contract Specifications](#)

[TABLE 14-2 Delivery Month Codes](#)

[TABLE 14-3 A Sample Currency Futures Quote](#)

[TABLE 14-4 Common Currency E-Mini and E-Micro Contracts](#)

Chapter 15

[TABLE 15-1 Being OTM, ATM, or ITM](#)

[TABLE 15-2 The Bull Call Spread](#)

[TABLE 15-3 The Bear Put Spread](#)

[TABLE 15-4 Orders for Options Trades](#)

[TABLE 15-5 A Sample Options Table](#)

Chapter 16

[TABLE 16-1 Leading Cryptocurrencies](#)

List of Illustrations

Chapter 4

[FIGURE 4-1: A dealing box from the FOREX.com trading platform for EUR/USD.](#)

Chapter 6

[FIGURE 6-1: Trend lines drawn off key highs and lows can be used to identify im...](#)

[FIGURE 6-2: The anatomy of a candlestick. Candlesticks provide a highly intuiti...](#)

[FIGURE 6-3: A double-bottom formation suggests that the prior trend down may re...](#)

[FIGURE 6-4: An inverted head-and-shoulders formation in EUR/USD signals that th...](#)

[FIGURE 6-5: A break of a bear flag consolidation pattern on an hourly chart of ...](#)

[FIGURE 6-6: The break of the flat top in an ascending-triangle formation signal...](#)

[FIGURE 6-7: After a move higher in AUD/USD, a doji signals the gains may be abo...](#)

[FIGURE 6-8: A shooting star signals a price peak and potential for a downside r...](#)

[FIGURE 6-9: Spinning tops are similar to doji both in shape and in that they su...](#)

[FIGURE 6-10: A tweezer top and bottom formation signals that an upmove is set t...](#)

[FIGURE 6-11: You can identify future support and resistance levels by drawing F...](#)

[FIGURE 6-12: Ichimoku charts provide a quick way to identify trend direction an...](#)

Chapter 7

[FIGURE 7-1: Job market trends coincide very closely with stock market performan...](#)

Chapter 8

[FIGURE 8-1: A one-minute EUR/USD chart showing periods of backing and filling.p...](#)

[FIGURE 8-2: USD/JPY exchange rate and yields on two-year U.S. Treasury notes ov...](#)

[FIGURE 8-3: Hourly USD/JPY chart highlighting spike reversals \(circled areas\). ...](#)

Chapter 10

[FIGURE 10-1: Placing stop-loss orders to trade a breakout identified with trend...](#)

Chapter 11

[FIGURE 11-1: Trend-line levels can change over time, depending on their slope.](#)

Chapter 13

[FIGURE 13-1: 20-year dollar index chart.](#)

[FIGURE 13-2: Five-year chart of UUP.](#)

[FIGURE 13-3: Five-year chart of UDN.](#)

[FIGURE 13-4: Five-year chart of FXE.](#)

[FIGURE 13-5: Five-year chart of EUO.](#)

[FIGURE 13-6: Five-year chart of FXY.](#)

Chapter 16

[FIGURE 16-1: Bitcoin's lifetime chart.](#)

[FIGURE 16-2: Bitcoin's five-year chart.](#)

[FIGURE 16-3: Ethereum's five-year chart.](#)

[FIGURE 16-4: Dogecoin's five-year chart.](#)

Appendix

[FIGURE A-1: EUR/USD short-term chart, Example 1.](#)

[FIGURE A-2: EUR/USD short-term chart, Example 2.](#)

[FIGURE A-3: AUD/USD short-term chart, Example 3.](#)

[FIGURE A-4: EUR/USD two-minute chart.](#)

[FIGURE A-5: An example of a Fibonacci buy strategy.](#)

[FIGURE A-6: NZD/USD hourly chart.](#)

[FIGURE A-7: NZD/USD hit the target.](#)

[FIGURE A-8: GBP/USD hourly chart.](#)

[FIGURE A-9: GBP/USD hourly chart after the economic data.](#)

[FIGURE A-10: Using moving averages to make a trade.](#)

[FIGURE A-11: NZD/USD short-term chart.](#)

[FIGURE A-12: EUR/USD daily chart.](#)

Introduction

Today, millions of individual traders and investors all over the world are discovering the excitement and challenges of trading in the forex (short for “foreign exchange”) market. You don’t even have to be at your desk to trade — these days, you can trade on the go using a smartphone or other handheld device.

No question about it, the forex market can be one of the fastest and most volatile financial markets to trade. Money can be made or lost in a matter of seconds or minutes. At the same time, currencies can display significant trends lasting several days to weeks and even years. Most important, forex markets are always moving, providing an accessible and target-rich trading environment.

In contrast to stock markets, which are more familiar and relatively intuitive to most investors, the forex market somehow remains more elusive and seemingly complicated to newcomers.

In this book, we show you how the forex market really works, what moves it, and how you can actively trade it. We also provide you with the tools you need to develop a structured game plan for trading in the forex market without losing your shirt.

About This Book

If you’re an active trader looking for alternatives to trading stocks or commodity futures, the forex market is hard to beat due to its sheer size (more than \$6 trillion turnover per day at last count) and the depth of the market.

But as an individual trader, gaining access to the forex market is only the beginning. Just because you've got the keys to a Formula One race car doesn't mean you're ready to compete in a Grand Prix. First, you have to understand how the car works. Then you have to figure out some of the tactics and strategies the pros use. And *then* you have to get behind the wheel and practice, developing your skills, instincts, and tactics as you go.

To succeed in the forex market, you have to do the same. This book gives you the no-nonsense information you need, with the perspective, experience, and insight of forex market veterans. In this book, we cover the following:

- » Getting a handle on the forces that drive currency movements
- » Understanding forex market trading conventions and strategies
- » Interpreting economic data and official statements
- » Finding sources of data and market intelligence
- » Gauging market psychology, sentiment, and positioning
- » Identifying key traits of individual currency pairs
- » Utilizing technical analysis to spot trade opportunities
- » Developing a regimented and disciplined approach to trading currencies
- » Focusing on risk management to minimize losses and keep more of your gains

Whether you're an experienced trader in other markets looking to expand into currencies, or a total newcomer to trading looking to start out in currencies, this book has what you need. Best of all, it's presented in the easy-to-

use *For Dummies* format. Divided into easy-to-follow parts, this book can serve as both your reference and troubleshooting guide.

Note: Trading foreign currencies is a challenging and potentially profitable opportunity for educated and experienced investors. However, before deciding to participate in the forex market, you should carefully consider your investment objectives, level of experience, and risk appetite. Most important, don't invest money you can't afford to lose. The leveraged nature of forex trading means that any market movement will have an equally proportional effect on your deposited funds; this may work against you as well as for you. (To manage exposure, employ risk-reducing strategies such as stop-loss or limit orders.) Any off-exchange foreign exchange transaction involves considerable exposure to risk, including, but not limited to, leverage, creditworthiness, limited regulatory protection, and market volatility that may substantially affect the price or liquidity of a currency or currency pair. Using the internet to trade also involves its own risks, including, but not limited to, the failure of hardware, software, and internet connection.

I (coauthor Paul) certainly can't do better on guiding you through the exciting and challenging world of forex than coauthors Kathleen and Brian. Since the third edition of this book, there have been exciting changes in the currency world that I think readers should be aware of. Here is a brief list of new content in this fourth edition to help you succeed in the world of currency trading:

- » Currency exchange-traded funds (ETFs) are a hot opportunity and a great vehicle for currency beginners.
- » Currency futures contracts offer speculators great opportunities.

- » Call and put options can add firepower to your currency trading pursuits.
- » The world of cryptocurrencies has exploded on the scene in recent years and is included.
- » You discover how to keep more of your currency trading profits with a chapter on taxes.

One last note: This book is a reference. You don't have to read it from beginning to end, in order; instead, you can use the table of contents and index to find the information you need right now. *Sidebar*s (text in gray boxes) and anything marked with the Technical Stuff icon are skippable — they're interesting but not essential to your understanding of currency trading. Also, within this book, you may note that some web addresses break across two lines of text. If you're reading this book in print and you want to visit one of these web pages, simply key in the web address exactly as it's noted in the text, pretending as though the line break doesn't exist. If you're reading this as an e-book, you've got it easy — just click the web address to be taken directly to the web page.

Foolish Assumptions

Making assumptions is always a risky business, but knowing where we're coming from may help put you at ease. Obviously, not all these assumptions will apply to you, but at least we'll have it all out in the open. In writing this book, we assume the following:

- » You've heard about currency trading, and you're looking to find out more about what's involved before you try it.

- » You're intrigued by the international dimensions of the forex market, and you want to find out how to profit from currency movements.
- » You're seeking to diversify your trading activities or hedge your investments.
- » You want to discover more about technical analysis and how it can be used to improve trading results.
- » You understand that trading currencies carries the risk of losses.
- » You're prepared to devote the time and resources necessary to understand what's involved in currency trading.
- » You have the financial resources to pursue margin trading, meaning that you'll never risk more than you can afford to lose without affecting your lifestyle.
- » You aren't gullible enough to believe the infomercials that promise easy money by trading currencies.
- » You understand that there is a big difference between gambling and speculating.

These assumptions should serve as a healthy reality check for you before you decide to jump into currency trading actively. A lot of it is similar to being a weekend golfer and being disappointed when your play doesn't reach pro-level scores. But when you think about it, why should it? The pros are out there practicing and playing all day, every day — it's their full-time job. Most people can only hope to get in a round on the weekend or get to the driving range for a few hours a week. Keep your perspective about what's realistic for you, and you'll be in a much better position to profit from actively trading.

Icons Used in This Book

Throughout this book, you see icons in the margins, highlighting certain paragraphs. Here are the icons we use and what they mean.



TIP

Theories are fine, but anything marked with a Tip icon tells you what currency traders *really* think and respond to. These are the tricks of the trade.



REMEMBER

Paragraphs marked with the Remember icon contain the key takeaways from this book and the essence of each subject's coverage.



WARNING

Achtung, baby! The Warning icon highlights potential errors and misconceptions that can cost you money, your sanity, or both.



TECHNICAL
STUFF

You can skip anything marked by the Technical Stuff icon without missing out on the main message, but you may find the information useful for a deeper understanding of the subject.

Beyond the Book

In addition to the material in the print or e-book you're reading right now, this product also comes with some access-anywhere goodies on the web. Check out the free Cheat Sheet for tips on choosing a broker for currency

trading, the fundamentals of currency rates, and more. To get this Cheat Sheet, simply go to www.dummies.com and search for “*Currency Trading For Dummies* Cheat Sheet” in the Search box.

Where to Go from Here

This book is set up so you can jump right into the topics that are of greatest interest to you. If you’re an absolute newcomer to trading in general and currencies in particular, we recommend reading [Parts 1](#) and [2](#) to build a foundation for the other topics. If you have more experience with trading, use the table of contents and index to find the subject you have questions about right now. This book is a reference — keep it by your computer and turn to it whenever you have a question. We wish you a successful journey in the world of currency trading.

Part 1

Getting Started with Currency Trading

IN THIS PART ...

Get a comprehensive overview of the forex market and how it works.

Find out what moves currencies.

Acquaint yourself with the main players in the forex market.

Understand the motivations behind trading decisions and simple strategies to get started.

Discover why the world's biggest market is the most fascinating market.

Chapter 1

Currency Trading 101

IN THIS CHAPTER

- » Looking at currency trading as a business
 - » Getting a sense of what moves currencies
 - » Developing trading strategies to exploit opportunities
 - » Implementing the trading plan
-

The forex (foreign exchange) market has exploded onto the scene and is the hot new financial market. It's been around for years, but advances in electronic trading have now made it available to individual traders on a scale unimaginable just a few years ago.

We've spent our professional careers in the forex market, and we can't think of a better traders' market. In our opinion, nothing quite compares to the speed and exhilaration of the forex market or the intellectual and psychological challenges of trading in it. We've always looked at our work as essentially doing the same thing every day, but no two days are ever the same in the forex market. Not many people can say that about their day jobs, and we wouldn't trade it for the world, no pun intended.

What Is Currency Trading?

At its heart, currency trading is about speculating on the value of one currency versus another. The key words in that last sentence are *speculating* and *currency*. We think

that looking at currency trading from those two angles — or two dimensions, if you allow us to get a little philosophical — is essential.



REMEMBER

On the one hand, it's speculation, pure and simple, just like buying an individual stock or any other financial security, in the hope that it will make a profitable return. On the other hand, the securities you're speculating with are the currencies of various countries. Viewed separately, that means that currency trading is about both the dynamics of market speculation, or trading, and the factors that affect the value of currencies. Put them together and you've got the largest, most dynamic, and most exciting financial market in the world.

Throughout this book, we approach currency trading from those two perspectives, looking at them separately and blending them together to give you the information you need to trade in the forex market.

Speculating as an enterprise

Speculating is all about taking on financial risk in the hope of making a profit. But it's not gambling, and it's not investing. Gambling is about playing with money even when you know the odds are stacked against you. Investing is about minimizing risk and maximizing return, usually over a long time period. Speculating, or active trading, is about taking calculated financial risks to attempt to realize a profitable return, usually over a very short time horizon.

To be a successful trader in any market requires

» Dedication (in terms of both time and energy)

- » Resources (technological and financial)
- » Discipline (emotional and financial)
- » Decisiveness
- » Perseverance
- » Knowledge



REMEMBER But even if you have all those traits, there's no substitute for developing a comprehensive trading plan (see [Chapters 6](#), [10](#), and [11](#)). You wouldn't open up a business enterprise without first developing a business plan (at least we hope not!). So you shouldn't expect any success in trading if you don't develop a realistic trading plan and stick to it. Think of trading as if it were your own business, and approach it as you would a business enterprise, because that's what it is.



TIP Above all, try not to take your trading results too personally. Financial markets are prone to seemingly irrational movements on a regular basis, and the market doesn't know or care who you are and what your trade idea is.

Currencies as the trading vehicle

If you've heard anything at all about the forex market, it's probably that it's the largest financial market in the world, at least in terms of daily trading volumes. To be sure, the forex market is unique in many respects. The volumes are, indeed, huge, which means that liquidity is ever present. It also operates around the clock six days a

week, giving traders access to the market almost any time they need it. (In [Chapter 2](#), we give you a sense of the scale of the forex market and how it operates on a daily basis. In [Chapter 3](#), we look at who the major forex players are.)

Few trading restrictions exist — no daily trading limits up or down, no restrictions on position sizes, and no requirements on selling a currency pair short. (We cover all the mechanics and conventions of currency trading in [Chapter 4](#).)



REMEMBER *Selling a currency pair short* means you're expecting the price to decline. Because of the way currencies are quoted and because currency rates move up and down all the time, going short is as common as going long.

Most of the action takes place in the major currency pairs, which pit the U.S. dollar (USD) against the currencies of the *Eurozone* (the European countries that have adopted the euro as their currency), Japan, Great Britain, and Switzerland. There are also plenty of trading opportunities in the minor pairs, which see the U.S. dollar traded against the Canadian, Australian, and New Zealand dollars. On top of that, there's cross-currency trading, which directly pits two non-USD currencies against each other, such as the Swiss franc against the Japanese yen. Altogether, there are anywhere from 15 to 20 different major currency pairs, depending on which forex brokerage you deal with. (See [Chapters 5](#) and [7](#) for a look at the fundamental and market factors that affect the most widely traded currency pairs.)

Most individual traders trade currencies via the internet — on a desktop, tablet, or even smartphone — through a brokerage firm. Online currency trading is typically done on a margin basis, which allows individual traders to trade in larger amounts by leveraging the amount of margin on deposit.

One of the key features of the forex market is trading with leverage. The *leverage*, or margin trading ratios, can be very high, sometimes as much as 200:1 or greater, meaning a margin deposit of \$1,000 could control a position size of \$200,000. (**Note:** Margin rules can vary by country.) Trading on margin is the backdrop against which all your trading will take place. It has benefits, but it carries its own rules and requirements as well. Leverage is a two-edged sword, amplifying gains and losses equally, which makes risk management the key to any successful trading strategy.



WARNING Before you ever start trading in any market, make sure you're only risking money that you can afford to lose, what's commonly called *risk capital*. Risk management is the key to any successful trading plan. Without a risk-aware strategy, margin trading can be an extremely short-lived endeavor. With a proper risk plan in place, you stand a much better chance of surviving losing trades and making winning ones. (We incorporate risk management throughout this book, but especially in [Chapters 11](#) and [18](#).)



REMEMBER

Downturns don't affect the forex market as they do other financial markets. Selling a currency pair is normal in the forex market. This is different from other markets — for example, stock markets, where retail investors rarely sell physical stocks due to the financial risks involved. Because selling is so common in the forex market, the forex market is fairly immune to downturns. You trade one currency against another, so something is always going up, even in times of financial crisis. (We talk more about risk on and risk off and what this means for currencies in [Chapter 2](#).)

What Affects Currency Rates?

In a word, information is what affects currency rates. Information is what drives every financial market, but the forex market has its own unique roster of information inputs. Many different cross-currents are at play in the currency market at any given moment. After all, the forex market is setting the value of one currency relative to another, so at the minimum, you're looking at the themes affecting two major international economies. Add in half a dozen or more other national economies, and you've got a serious amount of information flowing through the market.

Fundamentals drive the currency market

Fundamentals are the broad grouping of news and information that reflects the macroeconomic and