

The secrets of foreign exchange trading

Australian traders weary of lacklustre sharemarket returns are looking to trade foreign exchange, but experts say there are a few things worth knowing before diving into the currency market.

Chief executive of broker Easy-Forex Robert Francis says playing the FX market is a different game to sharemarket investing.

Extreme volatility

Unlike the sharemarket, the FX market is open 24 hours a day six days a week, and market moves tend to be more volatile, which means gains and losses can be made quickly. Traders should be nimble and aware that a long-term trade in the market tends to be no longer than a week.

“I don’t think a lot of people realise just how volatile the FX market is, or the concept of leverage,” Francis says. “The biggest problem I find with new people coming into this market is that the mentality tends to be one of investing, not a trading mentality.”

Would be foreign exchange traders have the choice of using margin or contracts for difference products, which tend to be similar in nature. EasyForex offers a margin product where traders pay a small percentage, typically 1 per cent (called the margin) of the actual trade size.

Immediate losses

This high degree of so-called leverage means small moves in the \$A mean you can lose a lot of money very quickly.

“With our web-based trading platforms we offer a guaranteed stop loss at no costs in all market conditions,” Francis says.

CMC Markets, another major player, provides clients with the chance to trade FX contracts for difference, and leverage is typically around 1 to 10.

CMC Markets senior dealer Tim Waterer says foreign exchange is attractive to trade because the high volume means transaction costs tend to be lower – but the volatility can be dangerous.

Start off small

Francis concurs. “This is a fairly new market for people, so we encourage people to educate themselves. When clients open an account with us, we assign them an account manager to help them with that, and to get them using a demo account first,” he says.

“Then we encourage them to start off using a mini-account, which enables them to put on a trade for as little as \$25. That is your outlay, so your contract size is \$2500, but we limit their losses to \$25 on those first trades.”

Waterer says traders need to learn how to minimise trading risk by learning how and where to place stop-losses on their trades.

A stop-loss is an automatic trigger that limits the loss on a trade. If a trader buys the \$A against the \$US at parity and then sets the stop-loss at US95¢, it will limit any losses on the trade to 5 per cent if the currency falls.

“Traders also need to avoid taking a stab in the dark when putting on trades,” Waterer says.

Charted waters

They should educate themselves on how to use charting techniques to identify trades. Technical

analysis, as it is called, is one of the mainstays of FX investing. Proponents say it is a way of identifying patterns in how an asset trades over time, and then using those patterns to predict future moves.

So a currency trader may look at typical trends and patterns in the Australian dollar and trade from there.

Waterer says traders should be aware of the characteristics of a currency and base trades on them. One example, the \$A, along with the Canadian and New Zealand dollars, is considered a commodity currency, given the economy's reliance on commodity exports. So the \$A tends to move in line with commodity prices.

The US dollar, the Japanese yen and Swiss franc are considered safe-haven currencies, so they tend to rise when global financial markets become concerned about an issue such as the European sovereign debt crisis.

Many foreign exchange providers are aware of the popularity of technical analysis and therefore provide clients opening an account with a range of charting tools, Waterer says.

Popular trades

Investment Trends, a specialist market research company, undertook a survey of foreign exchange contracts for difference traders in 2010 and found eight out of 10 use technical analysis to identify trades. The report also found Australian retail investors overwhelmingly favoured trading the \$A/\$US (traders dabble, in order of popularity, in €/ \$US, £/\$US, \$US/¥ and the \$A/¥).

The biggest Australian foreign exchange specialists are IG Markets, FXCM, GFT and CMC Markets.

Foreign exchange trading has risen in popularity worldwide. In 2010, the Bank of International Settlements triennial survey of foreign exchange markets found that spot foreign exchange turnover had grown 48 per cent between surveys in 2007 and 2010. Total global foreign exchange turnover rose 20 per cent between April 2007 and April 2010 to \$US4 trillion a day,

The Australian dollar leapt past the Swiss franc to become the fifth most traded currency in the world, and only the US dollar, the euro, the yen and the pound were traded more than the \$A in global financial markets in April 2010 when the survey was undertaken.