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Forex trading

Preview

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Forex trading

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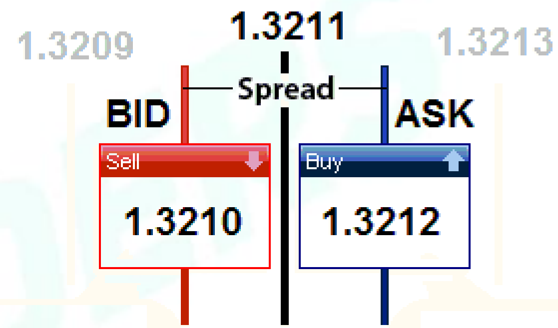
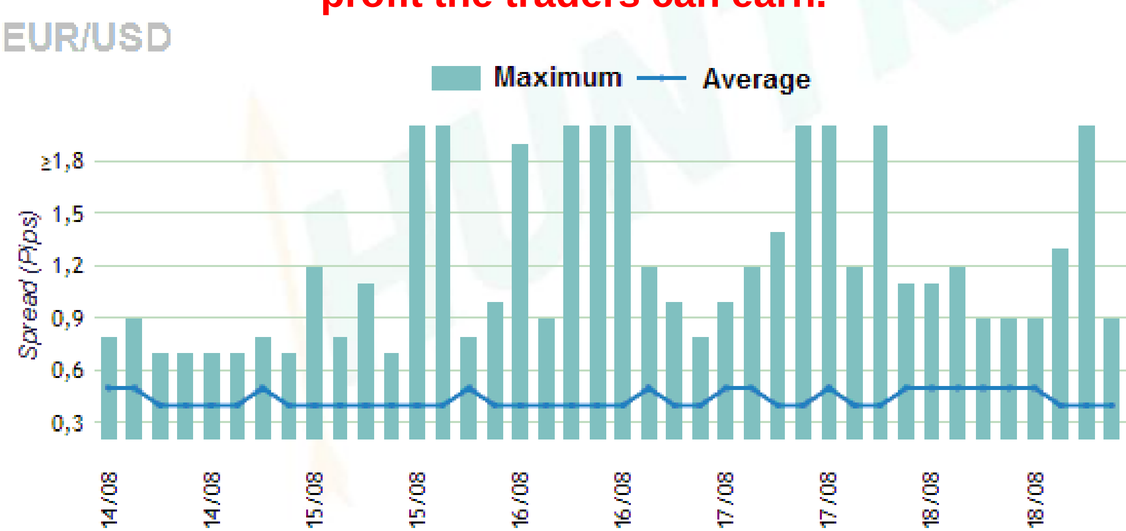
Spread

Spread is the difference between the bid price and the ask price.

For example, if the bid price of the EUR/USD is 1.3210 and its ask price is 1.3212, the spread will be 2 points. When the liquidity is high the spread may be lower, and higher when the liquidity is low. Brokerages profit from the spread. The spread is the traders’ cost. Thus, it is important to choose brokerages where the spread is low.



The lower the spread the more profit the traders can earn.



One can observe the EUR/USD currency pair’s spread on a weekly basis. The average spread was 0.4 *pip*, the maximum spreads could be above 2 *pip*. When spreads widen, it is usually due to market news.

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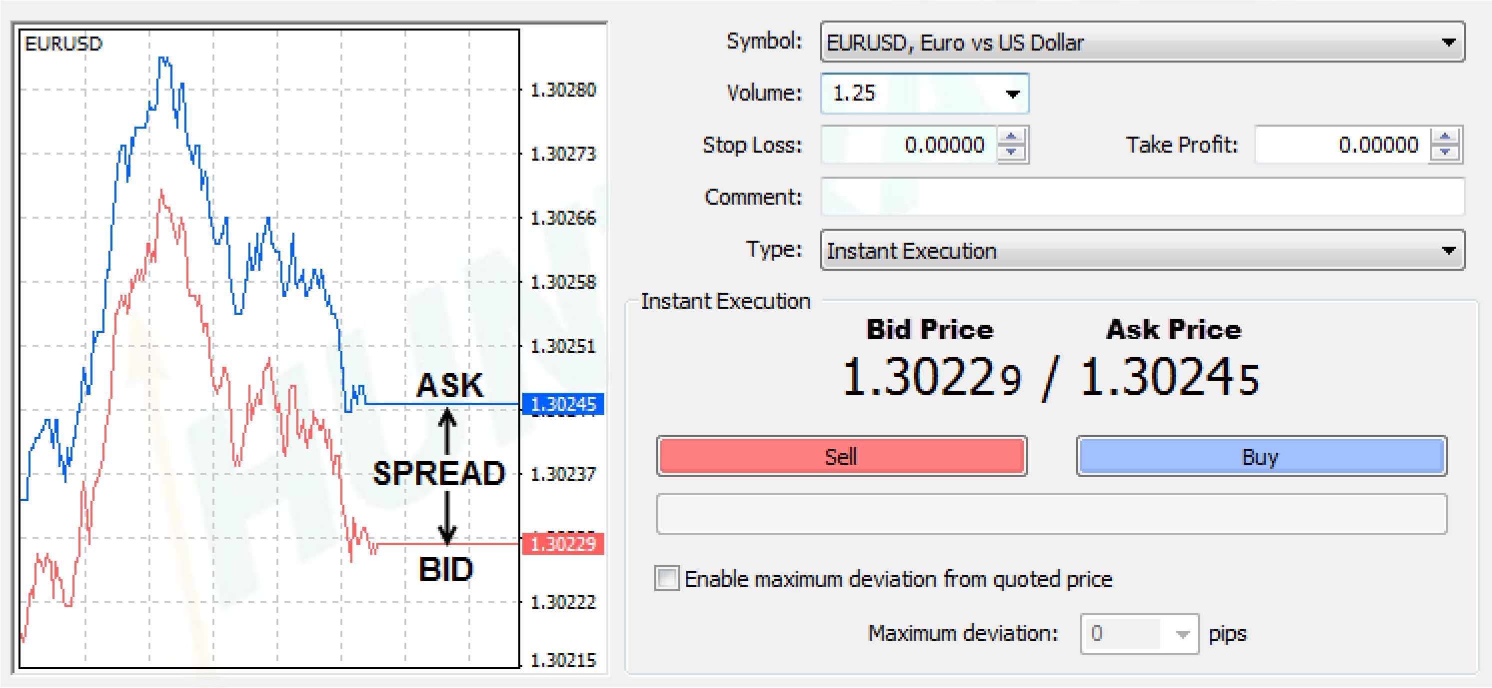
Spread

There are brokers who do not earn profit through spreads, but **charges a certain commission after every transaction** (brokerage fee or execution fee). This amount is usually 0.5-1.5 pip value. However, there is a spread here as well, but it is much lower. Spread is the difference between sell and buy offers, and is always a cost for traders.



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Drawdown

A drawdown is the reduction of one's capital after a series of losing trades. The capital loss since the last highest value.

Assume our account's initial value is USD 10,000 from which we lose USD 3,000. Then, we lost 30% of our account's initial value. To restore the account to its initial value, we must earn at least 40% return. **This capital loss is the drawdown.**

Lossmaking series

Assume that our trading strategy is generating profit in 70% of the cases. This means that 35 trades out of 50 will generate profit and 15 will generate losses.

However, it may cause difficulties if the lossmaking deals are not evenly distributed but consecutive.

A good currency trader uses money management systems because he knows that not every position will be profitable. Thus, they will risk only a small amount of their account so they can overcome a lossmaking series.

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Drawdown

Ratio of win trades	The probability of consecutive lossmaking trades (from 50 trades)									
	2	3	4	5	6	7	8	9	10	11
5%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
10%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
15%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
20%	100%	100%	100%	100%	100%	100%	100%	100%	99%	97%
25%	100%	100%	100%	100%	100%	100%	99%	96%	91%	82%
30%	100%	100%	100%	100%	100%	98%	92%	82%	69%	55%
35%	100%	100%	100%	100%	97%	89%	75%	59%	43%	30%
40%	100%	100%	100%	98%	88%	71%	52%	35%	22%	14%
45%	100%	100%	99%	91%	72%	49%	30%	18%	10%	5%
50%	100%	100%	95%	77%	51%	29%	16%	8%	4%	2%
55%	100%	99%	86%	58%	31%	15%	7%	3%	1%	1%
60%	100%	96%	70%	38%	17%	7%	3%	1%	0%	0%
65%	100%	88%	51%	22%	8%	3%	1%	0%	0%	0%
70%	99%	73%	32%	11%	3%	1%	0%	0%	0%	0%
75%	96%	53%	17%	4%	1%	0%	0%	0%	0%	0%
80%	87%	32%	7%	2%	0%	0%	0%	0%	0%	0%
85%	67%	15%	2%	0%	0%	0%	0%	0%	0%	0%
90%	39%	5%	1%	0%	0%	0%	0%	0%	0%	0%
95%	12%	1%	0%	0%	0%	0%	0%	0%	0%	0%

Pip

Pip is the smallest possible movement in a currency's price.

EUR/USD = 1.1051

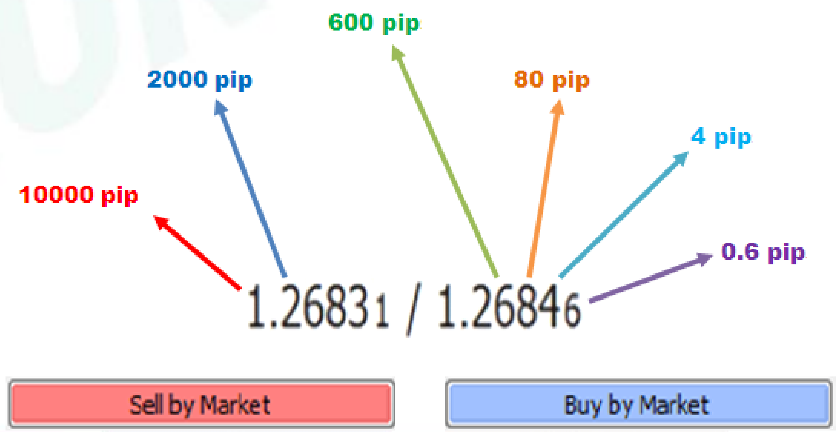
pip

GBP/USD = 1.30543

pipette

If the EUR/USD price changes from 1.1050 to 1.1051, the change is 1 *pip.* Pip is the last decimal in the fraction, and pip helps to measure profits and losses.

Some brokerages may use 5 or 3 decimals instead of 4 or 2. This kind of pip is sometimes called *pipette.* For example, if the GBP/USD changes from 1.30542 to 1.30543, the price has increased by 1 pipette.



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Pip

Since every currency has a unique value, it is necessary to express pips in other currencies as well. In currency pairs, in which **USD is the first**, the calculation is the following.

The price of USD/JPY currency pair is 119.80 (this pair is only expressed in 2 decimals, but most pairs are expressed in 4).

Therefore, 1 pip = 0.01

USD/JPY: 119.80 yen
0.01 / price = value of 1 *pip*

0.01 / 119.80 = 0.0000834

USD/CAD: 1.4890 Canadian dollar
0.0001 / price = value of 1 *pip*

0.0001 / 1.4890 = 0.00006715

USD/CHF: 1.5250 franc
0.0001 / price = value of 1 *pip*

0.0001 / 1.5250 = 0.0000655

These values may seem really low, but it will be important for the definition of lot and for calibrating the position size.

Pip

If USD is not the first currency in the currency pair, but we would like the value expressed in USD, we need one further step.

EUR/USD: USD 1.2200

0.0001 / price = value of 1 *pip*

0.0001 / 1.2200 = 0.00008196 euro.

But we need it in USD, so we need to recalculate it:

EUR x price

0.00008196 x 1.2200 = 0,00009999

Which is rounded to 0.0001.

GBP/USD: USD 1.7975

0.0001 / price = value of 1 *pip*

0.0001 / 1.7975 = 0.0000556 pounds.

We also need the USD value:

GBP x price

0.0000556 x 1.7975 = 0.0000998

Rounded to 0.0001.

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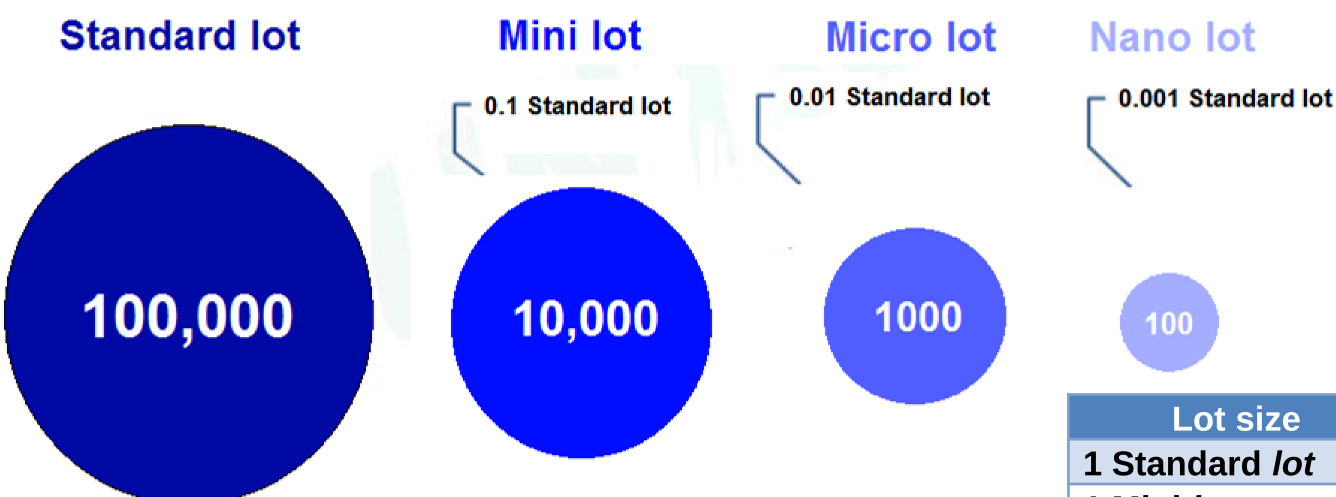
Lot

Lot means the units of base currency. It measures the size of market or limit orders.

On the spot market *lots* are traded. A standard lot is 100,000 units of the base currency. There are also mini lots (10,000), micro lots (1,000), and nano lots (100).

Currency prices are measured in pips which is the smallest movement in a currency's price. To exploit this small movement, larger amount of currency must be moved to earn significant profit (or loss).



Lot size	Pip value (USD)
1 Standard *lot*	1 *pip* = USD 10
1 Mini *lot*	1 *pip* = USD 1
1 Micro *lot*	1 *pip* = USD 0.1
1 Nano *lot*	1 *pip* = USD 0.01

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Lot

In the following examples a USD 100,000 lot size is used. The examples show how lot size can change the pip value.

USD/JPY: 119.80

(0.01 / 119.80) x 100,000 USD
Result = **USD 8.34/pip**

USD/CHF: 1.4555

(0.0001 /1.4555) x 100,000 USD
Result = **USD 6.87/pip**

The formula changes if USD is not the base currency anymore.

EUR/USD: 1.1930

(0.0001/1.1930) x 100,000 USD =
8.38 euro x 1.1930 =
USD 9.99734, so USD 10/pip

GBP/USD: 1.8040

(0.0001/1.8040) x 100,000 USD =
5.54 pound x 1.1930 =
USD 9.99416, so USD 10/pip

The pip value moves together with the market based on the traded currency.

Would you like to learn more?

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The thematically built courses will teach you from the basics how to manage your investments and how to maximise your profits.

The techniques and analyses explained by colourful illustrations and understandable examples will help you to trade like an expert!

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- what others can only do with speculation and guessing
- what other traders currently use to earn millions right now!

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