

# Learning Center

## A03 Chapter 03

### Understand the Mechanics

1. Currencies And Currency Pairs
2. Measuring The Trade
3. Margin And Leverage
4. Types Of Orders



#### Topics covered in this chapter:

- Main characteristics of major currencies and their economies.
- Definitions of currency pairs and how synthetic pairs are made. The [pip](#) value is a variable, how it can be calculated and why its value matters.
- The spread and how to overcome the break even point in a trade.
- The rollover: calculate it and integrate it as an edge to your trading.
- How to distinguish the maximum margin requirement from the effective [leverage](#). Understand [leverage](#) once and for all.
- Types or [orders](#) available in most Forex trading platforms.

In this chapter the student will learn what can be traded in spot Forex and how it is done. We will start by defining the currency pairs and the mechanics of trading: more complicated concepts like margin and [leverage](#) will be covered in details as well as calculations of [pip](#) values, spreads and rollovers.



**What do I need to learn to become a trader?** You don't need a superior intelligence to succeed at trading. A formal education, such as mathematics or economy is not a disadvantage, but it's not a guarantee of success either. We will teach you here what you need to know: the foundations to stand on and build your experience upon. Once understood the basics, traders learn through study, trial and error, testing and analysis. It is very important though, to hold realistic expectations from the very beginning.

# 1. Currencies and Currency Pairs

## The Exchange Rate

The concept of buying and selling capital can be initially confusing because you're not buying any asset in exchange for money, like you do in the stock market, for example. Instead you are simultaneously buying one currency and selling another, that is, doing an exchange.

In the stock market, traders buy and sell shares; in the [futures market](#), traders buy and sell contracts; in the Forex market, traders buy and sell "[lots](#)". When you buy a currency lot, you are speculating on the value of one currency compared to another, that is, on the exchange rate itself.

Currencies are traded in pairs. The pair is written in a particular format, best demonstrated by way of two examples. The Euro and the US Dollar:

EUR/USD

or the British Pound and the Japanese Yen:

GBP/JPY

**Every purchase of one currency implies a reciprocal sale of the other currency, and vice versa. This means that buying equals selling - curious isn't it? But the fact is that you are buying and selling the exchange rate, not a single currency.**

Imagine if currencies would be traded single and you would want to buy 100 US Dollars. Do you think it would be easy to find someone offering more than 100 Dollars for the same amount? Probably not. The value of a currency does not change in itself, what changes is its value in relation to other currencies. This is a characteristic of a free floating exchange rate system, as you learned in the previous chapter.

If you hear another trader saying "I'm buying the Euro", he/she is expecting that the value of the Euro will rise against the US Dollar and speculates by buying the EUR/USD exchange rate. The trader's ability to anticipate how the exchange rate will move will determine if the trade will represent a win or a loss.

The first member of every pair is known as the "base" currency, and the second member is called the "[quote](#)" or "counter" currency. The International Organization for Standardization (ISO) decides which currency is the base and which one is the [quote](#) within each pair.



This is the current list of [currency codes as published by the International Organization for Standardization \(ISO\)](#).

The exchange rate shows how much the [base currency](#) is worth as measured against the counter currency. For example, if the USD/CHF rate equals 1.1440, then one US Dollar is worth 1.1440 Swiss francs. Remember, the value of the [base currency](#) is always quoted in the counter currency member within the pair (hence the name "[quote](#) currency"). A simple rule to understand the exchange rates would be to think of the [base currency](#) as one unit of that currency being worth the value of the exchange rate expressed in the [quote](#) currency.



Go to the world [Foreign Exchange Rates table](#) and select the currencies of your choice to get a picture how each of the major currencies behaves in relation to all the others.

Following the previous example, one US Dollar is worth 1.1440 Swiss Francs.

Therefore, any unrealized profit or loss is always expressed in the [quote](#) currency. For example, when selling 1 US Dollar, we are simultaneously buying 1.1440 Swiss francs. Likewise, when buying 1 US Dollar, we are simultaneously selling 1.1440 Swiss francs.

We can also express this equivalence by inverting the USD/CHF exchange rate to derive the CHF/USD rate, that is:

$$\text{CHF/USD} = (1/1.1440) = 0.874$$

This means that the [quote](#) of one Swiss franc is 0.874 US Dollars. Note that CHF has now become the [base currency](#) and its value is accrued in USD.

In spot Forex, not all pairs have the US Dollar as the [base currency](#). Primary exceptions to this rule are the British Pound, the Euro and the Australian and New Zealand Dollar.

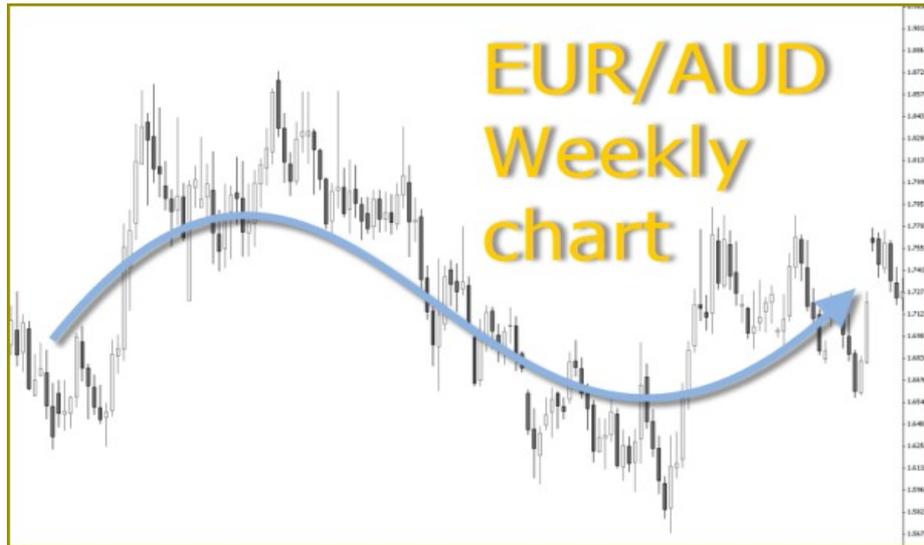
GBP/USD, EUR/USD, AUD/USD, NZD/USD

When looking at a [chart](#) you can see if a currency pair, or in other words, the exchange rate between two currencies, is rising or falling.



In the above example the [chart](#) illustrates the strength of the [base currency](#), the Euro, relative to the [quote](#) currency, the US Dollar. Remember, the [quote](#) currency is the one in which the exchange rate is quoted.

The next [chart](#) shows the same [base currency](#) but this time relative to the Australian Dollar. Both [charts](#) comprise the same period and as you can see, the value of the Euro has shown a different behavior towards the USD than towards the AUD.



Our [Rates and Charts section](#) is a superb place to familiarize yourself with different [chart](#) types and charting packages.

In a free floating system, there are two main factors that can affect exchange rates every day: international trade (import/export of commodities, manufactured goods and services) and capital flows (following certain interest rates, equity performance, government debt instruments like bonds).

It is by buying and selling a currency, therefore exchanging it with other currencies, that it becomes stronger or weaker, independently from the fact of this transaction being speculative or not.

Basically there are two main methods to estimate where a currency is heading: analyzing the economic fundamentals and analyzing the price action through technical analysis.

The first refer to the economic and political factors that influence the value of currencies, such as the release of economical data and news. **Currencies reflect the performance and policies of entire economies, sovereign governments and industry. It is the comparison of different currencies and their economies that drives exchange rates up and down.**

The second are graphical representations of the exchange rates like you see above. Price [charts](#) show [supply and demand](#) levels represented through price patterns which can be recognized visually. As a numerical sequence, price series can be also technically analyzed using mathematical formulas, represented by technical indicators.



In [Unit C](#), you will be familiarized with such fundamental and technical analytical resources. They will help you to interpret the market in a meaningful way. But before you start to interpret, there is a lot of information about price action that you can obtain simply through observation. Chapters [A03](#) and [A04](#) will teach you just that.



Trading Forex is in fact like trading entire economies. A huge difference compared to equities - where companies are traded - is that [trends](#) in Forex can last very long. Due to the fact that macroeconomic events can continue to influence the market over a time frame of months and years, an economy that is weak tends to stay weak for a long time. A company that is in trouble can be turned around fairly quickly, but not an entire economy.

Many retail traders feel the need to buy and sell bottoms on the [charts](#), hopping for a turn-around, but the fact is that a currency that has been weakening can always go lower in value, and one that has been gaining strength can always go higher too. The lesson here is that if you want to fight [trends](#) in the Forex world, be sure to have a sound and tested method able to capitalize on such circumstances.



Observe the market closely. To achieve success in Forex, you must become an astute observer. Download a free charting platform and take

notes each day on the patterns and the constants you discover. In the beginning you will see just candles making mountains and valleys on the [chart](#), with no further meaning, but with time and persistence, patterns will start to emerge and you will be able to pick up behavior constants from the [charts](#). Start focusing on one or two pairs only, and don't overflow you with too much information. To trade for a living you won't need to trade with 10 pairs at once. In fact, many professional traders specialize in only one or two currency pairs.

Before proceeding further into the mechanics, let's devote a moment to the currency pairs themselves.

## Currency Pairs

The following is a list of the most frequently traded currencies, their trading symbols, their nicknames and major characteristics:

### USD (US Dollar)

The US Dollar is by far the most transacted currency in the world. This is due to several factors as you have already learned in the last chapter. First, it's the world's primary reserve currency, which makes this currency highly susceptible to changes in interest rates. Second, the USD is a universal measure to evaluate any other currency as well as many commodities such as oil (hence the term "petrodollar") and gold.

Today's other major currencies like the Euro, the British Pound, the Australian Dollar and New Zealand Dollar are moving against the American currency, and so do the Japanese Yen, the Swiss franc and Canadian Dollar.

70% of the U.S economy depends on domestic consumption, making its currency very susceptible to data on employment and consumption. Any



Source: <http://en.wikipedia.org>

contraction in the labor market has a negative effect on this currency.

All US Dollar denominated bank deposits held at foreign banks or foreign branches of American banks are known as "Eurodollars". Some economists maintain that the overseas [demand](#) for Dollars allows the United States to maintain persistent trade deficits without causing the value of the currency to depreciate and the flow of trade to readjust. Other economists believe that at some stage in the future these pressures will precipitate a run against the US Dollar with serious global financial consequences.

Nickname: Buck or [Greenback](#)

## EUR (Euro)

The European Monetary Union is the world's second largest economical power. The Euro is the currency shared by all the constituting countries which also share a single monetary policy dictated by the [European Central Bank \(ECB\)](#).



Source: <http://en.wikipedia.org>

This currency is both a trade driven and a capital flow driven economy. Before the establishment of the Euro, [central banks](#) didn't accumulate large amounts of every single European national currency, but with the introduction of the Euro it

is now reasonable to diversify the foreign reserves with the single currency. This increasing [acceptance](#) as a reserve currency makes the Euro also very susceptible to changes in interest rates.

The effect of the Euro competing with the Dollar for the role of reserve currency is

misleading.

It gives observers the impression that a rise in the value of the Euro versus the US Dollar is the effect of increased global strength of the Euro, while it may be the effect of an intrinsic weakening of the Dollar itself.

Nickname: [Fiber](#) or Single Currency

## JPY (Japanese Yen)

The Japanese Yen, despite belonging to the third most important single economy, has a much smaller international presence than the Dollar or the Euro. The Yen is characterized by being a relatively liquid currency 24 hours.

Since much of the Eastern economy moves according to Japan, the Yen is quite sensitive to factors related to Asian stock exchanges. Because of the interest rate differential between this currency and other major currencies that preponderated for several years, it is also sensitive to any change affecting the so-called "Carry Trade". Investors were then shifting capital away from Japan in order to earn higher yields. However, in times of financial crisis when risk tolerance increases, the Yen is not used to fund carry trades and is punished accordingly. When volatility surges to dangerous levels, investors try to mitigate risk and are expected to park their money in the least risky capital markets. That means those in the US and Japan.

The concept of carry trade will be disclosed later in this chapter, but a short definition would be: a strategy which involves buying or lending a currency with a high interest rate and selling or borrowing a currency with a low interest rate.

Japan is one of the world's largest exporters, which has resulted in a consistent trade surplus. A surplus occurs when a country's exports exceed its imports, therefore an inherent demand for Japanese Yen derives from that surplus situation. Japan is also a large importer and consumer of raw materials such as oil. Despite the Bank of Japan avoided raising

interest rates to prevent capital flows from increasing for a prolonged period, the Yen had a tendency to appreciate. This happened because of trade flows. Remember, a positive balance of trade indicates that capital is entering the economy at a more rapid rate than it is leaving, hence the value of the nation's currency should rise.



Source: <http://en.wikipedia.org>



These are the milestones in the Yen's 137-year history, from 1871 until the December, 12 2008 when the Yen hit a 13-year high versus the US Dollar.



In some countries the fiscal year and calendar year are not identical. In Japan the start of a new fiscal year is April 1st. Japanese companies usually 'dress up' their balance sheets ahead of the fiscal year-end, by liquidating foreign holdings and bringing home the profits from overseas subsidiaries, in order to raise their bottom lines. This capital flows prior to the start of the new fiscal year, and the fact that banking trading desks lower their transaction volumes, condition the exchange rates and price action in all pairs containing the Yen.

## GBP (Pound Sterling)

This was the reference currency until the beginning of World War II, as most transactions took place in London. This is still the largest and most developed financial market in the world and as a result banking and finance have become strong contributors to the national economical growth. The United Kingdom is known to have one of the most effective [central banks](#) in the world, the Bank of England ([BOE](#)).

The Sterling is one of the four most [liquid](#) currencies in the Forex arena and one of the reasons is the mentioned highly developed capital market.

While 60% of the volume of foreign exchange are made via London, the Sterling is not the most traded currency. But the good reputation of the monetary policy of Great Britain and a high interest rate for a long time contributed to the popularity of this currency in the financial world.



Source: <http://en.wikipedia.org>

Nickname: [Cable](#) or simply Sterling



Even though the economic unit using the Pound Sterling is technically the United Kingdom rather than Great Britain, the ISO currency code is GBP and not UKP as sometimes abbreviated. The full official name of the currency "Pound Sterling", is used mainly in formal contexts and also when it is necessary to distinguish the United Kingdom currency from other currencies with the same name such as the Guernsey Pound, Jersey Pound or Isle of Man Pound.

The currency name is sometimes abbreviated to just Sterling, particularly in the wholesale financial markets, while the term British Pound is commonly used in less formal contexts, although it is not an official name for the currency.

## CHF (Swiss franc)



Several factors such as a lengthy history of political neutrality and a financial system known for protecting the confidentiality of its investors, have created a safe haven reputation for Switzerland and its currency. Being the world's largest destination of [offshore](#) capital.

The Swiss franc moves primarily on external events rather than domestic economic conditions, and is therefore sensitive to capital flows as risk-averse investors pile into Franc-denominated assets, during global [risk aversion](#) times. Also much of the debt from Eastern European economies is denominated in Swiss Francs.

Source: <http://en.wikipedia.org>

Nickname: Swissy

## CAD (Canadian Dollar)

Canada is commonly known as a resource based economy being a large producer and supplier of oil. The leading export market for Canada is by far the United States making its currency particularly sensitive to US consumption data and economical health.



Source: <http://en.wikipedia.org>

Being a highly commodity dependent economy, the CAD is very correlated to oil - meaning that when oil [trends](#) higher, USD/CAD tends to [trend](#) lower and vice versa.

Nickname: [Loonie](#)



If Canada is one of the world's largest producers of oil and is such a big part of the US economy, rising oil prices tend to have a negative effect on the USD and a positive effect on the CAD. Here you have two nice correlations.

But if you are willing to find a pair which is really sensitive to oil prices, then pick the CAD/JPY. Canada and Japan are at the extreme ends of production and consumption of oil. While Canada benefits from higher oil prices, Japan's economy can suffer because it imports nearly all of the oil it consumes. This is another interesting correlation to follow. A brent crude oil spot [chart](#) is available at our [World Indexes section](#).



The nickname "[Loonie](#)" is derived from the picture of a loon, a distinctive bird which appears on one side of the Canada's gold-colored, one Dollar coin.

## AUD (Australian Dollar)

Australia is a big exporter to China and its economy and currency reflect any change in the situation in that country. The prevailing view is that the Australian Dollar offers diversification benefits in a portfolio containing the major world currencies because of its greater exposure to Asian economies. This correlation with the Shanghai stock exchange is to be added to the correlation it has with gold. The pair AUD/USD often rises and falls along with the price of gold. In

the financial world, gold is viewed as a safe haven against [inflation](#) and it is one of the most traded commodities. Together with the New Zealand Dollar, the AUD is called a commodity currency. Australia's dependency on commodity (mineral and farm) exports has seen the Australian Dollar [rally](#) during global expansion periods and fall when mineral prices slumped, as commodities now account for most of its total exports.



Source: <http://en.wikipedia.org>



**What is a commodity currency?** A commodity currency is a currency whose country's exports are largely comprised of raw materials (precious metals, oil, agriculture, etc.).

Among the most actively traded and therefore [liquid](#) currencies are the NZD, the AUD and the CAD. "Commodity Dollars" or "Comdolls" is another term to describe these currencies.

The interest rates set by the Reserve Bank of Australia (RBA) have been the highest among industrialized countries and the relatively high [liquidity](#) of the AUD has made it an attractive tool for carry traders looking for a currency with the highest yields. These factors made the AUD very popular among currency traders. It's the 6th most traded currency in the world accounting for an estimated 6.8% of worldwide FX transactions in 2007, far in excess of the economy's importance (2% of global economic activity).

The AUD is under a free floating regime since 1983. Before that it was pegged to a group of currencies called the trade weighted index (TWI).

Nickname: [Aussie](#)

## NZD (New Zealand Dollar)



Source: <http://en.wikipedia.org>

This currency behaves similar to the AUD because New Zealand's economy is also trade oriented with much of its exports made up of commodities. The NZD also moves in tandem with commodity prices.

As per estimates from the last [BIS](#) triennial survey, in 2007 the NZD accounted for a daily transaction share volume of 1,9% of total Forex transactions, after the Norwegian Krone, the Hong Kong Dollar and the Swedish Krone.

Along with the Australian Dollar, the NZD has been for many years a traditional vehicle for carry traders, which has made this currency also very sensitive to changes in interest rates. In 2007 the NZD was mainly used to conduct carry trades against the Japanese Yen accounting for a higher volume than the Australian Dollar against the Yen.

Nickname: [Kiwi](#)

Although there are many currencies worldwide, the vast majority of all daily transactions involve the exchange of the so called "**major**" currency pairs:

- US Dollar / Japanese Yen (USD / JPY)
- Euro / US Dollar (EUR / USD)
- Pound Sterling / US Dollar (GBP / USD)
- US Dollar / Swiss Franc (USD / CHF)
- US Dollar / Canadian Dollar (USD / CAD)
- Australian Dollar / US Dollar (AUD / USD)

The pair is always expressed with the convention: **Base currency / Quote currency set by the Society for Worldwide Interbank Financial Telecommunication cooperative (SWIFT).**



The EUR/USD is the most [liquid](#) currency pair and all pairs containing the EUR are very [liquid](#). This currency is the result of the replacement of all largest European national currencies, such as the Deutsche Mark, French Franc, Italian Lira, Dutch Guilder, the Belgian Franc, among others. The conversion of these legacy currencies into one, coupled with the ongoing process of deregulation of cross-border transactions, enhanced market efficiency and helped the single currency challenge the supremacy of the US Dollar in international transactions. As described in the [BIS quarterly review of December 2007](#), "...the Euro area market currently accounts for 16% of total international interbank activity, up from 10% in 1998. Much of this has been fueled by greater use of the Euro, whose share in the [interbank market](#) hovered around 70% until 1998, but then increased steadily and has stabilized at 86% since 2003."

According to the last [triennial survey from 2007](#) made by the Bank of International Settlements, this is the daily turnover in the Forex market per major pairs.

- EUR/USD 27%
- USD/JPY 13%
- GBP/USD 12%
- AUD/USD 6%
- USD/CHF 5%
- USD/CAD 4%
- USD/Other 19%

For traders, the best trading opportunities are those related to the major currencies, because those are traded more frequently and are therefore more [liquid](#).



**What is a [liquid](#) currency?** - It's a currency which can be bought and sold with ease at any time, because there is always a counterpart for the transaction. In other words, there are more buyers and sellers in a liquid market than in an illiquid one. The terms "thick" or "deep" are also

commonly used to designate a high degree of [liquidity](#).

Other currency pairs are referred to as "**minors**" or "**exotic**" pairs. These are some of the lesser-traded pairs that contain the USD and a currency from a smaller and/or emerging economy:

- USD/SEK (US Dollar / Swedish Krone)
- USD/NOK (US Dollar / Norwegian Krone)
- USD/DKK (US Dollar / Danish Krone)
- USD/HKD (US Dollar / Hong Kong Dollar)
- USD/ZAR (US Dollar / South African Rand)
- USD/THB (US Dollar / Thai Baht)
- USD/SGD (US Dollar / Singapore Dollar)
- USD/MXN (US Dollar / Mexican Peso)

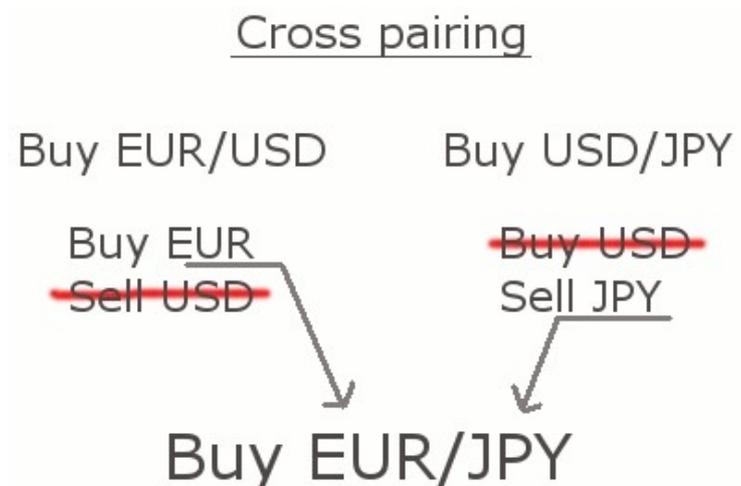


Visit the [Exotic Currencies section](#) to see their relative value to major currencies at a glance.

Other pairs where the US Dollar is not a member currency are called "**crosses**". Basically, a cross is any currency pair in which the US Dollar is neither the base nor the counter currency. For example, GBPJPY, EURJPY, EURCAD, and AUDNZD are all considered currency crosses.

When you think about buying or selling a cross currency pair, don't forget that the US Dollar, despite not being a member within the pair, is still influencing the price behavior of the cross. Buying EUR/JPY is equivalent to buying the EUR/USD currency pair and simultaneously buying the USD/JPY. Knowing from the [previous chapter](#) how interbank platforms work, you also understand why cross currency pairs frequently carry a higher transaction cost. To build a cross, interbank dealers have to combine two [orders](#) on different platforms.

The figure below shows the process of creating a cross currency pair.



By knowing how currencies are related and transacted you will be given a basic understanding on how to analyze trading opportunities on majors as well as on crosses. The principles guiding you to profit from a trade with a cross should be technically the same as with the majors: basically you want to analyze which is the strong and which is the weak currency within the pair.

By the same token, as crosses are created at the interbank level, you can create your crosses if they are not available with your preferred broker-dealer's platform. We call that creating "**synthetic**" pairs.

Let's assume a trader believes, based on a previous analysis, that there is an opportunity to profit from a weak Swedish Krone (SEK) and a strong Norwegian Krone (NOK), but the broker-dealer which the trader is using doesn't enable to sell the pair SEK/NOK. In this case all it takes is the trader to buy USD/SEK and to sell USD/NOK with equal position sizes. The position size depends on the [pip](#) value of the pair you are trading, as you will see later in this chapter.

Too many new concepts to put down a profitable trade? Don't worry, we will get there in a moment.

The figure below illustrates the process of synthetic pairing.

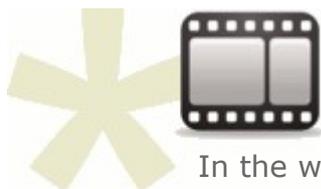
Synthetic pairing



Again, for a detailed view on all pairs and possible crossings:  
[Exotic currency](#)  
 or  
[World currency](#)  
 or even  
[Currency rates](#)



If you trade several pairs simultaneously, don't get overweight in one currency, unless the risk has been diversified. For instance, buying the EUR/USD and being short in the USD/CHF is like having twice the exposure to the same factors, as these pairs are highly correlated. You'd better monitor several pairs and trading just one, for instance, by following the EUR/GBP when trading the GBP/USD. Although the GBP/USD is a more liquid currency than EUR/GBP, EUR/GBP is typically a good indicator for GBP strength.



In the webinar titled [Emerging market currencies](#) by John Jagerson, you can get a look at developing Asian and Latin American currencies and some developing opportunities in Eastern Europe.

To get a feel for currency correlations, how they move in relation to each other, start familiarizing yourself with the US Dollar Index. Sunil Mangwani explains both concepts in his work: "Important Things To Know About Your Currencies":



The US Dollar Index measures the performance of the US Dollar against a basket of world currencies. This basket consists of the following currencies and their percentage weighting.

Euro 57.6%  
Japanese Yen 13.6%  
Great Britain Pound 11.9%  
Canadian Dollar 9.1%  
Swedish krona 4.2%  
Swiss franc 3.6%

...Since the Euro makes up a major portion of this basket, it is rather obvious that it should have a strong correlation with the US Dollar Index.

[Continue reading...](#)

Dan Blystone also explained the US Dollar Index during a chat dedicated to Forex trading correlations:



The US Dollar Index (USDX) is a futures contract offered by the New York Board of Trade. It is a trade-weighted average of six foreign currencies against the Dollar. Currently, the index includes Euros (EUR), Japanese Yen (JPY), British Pounds (GBP), Canadian Dollars (CAD), Swedish kronas (SEK) and Swiss francs (CHF).

...  
USDX broadly reflects the Dollar's standing compared to the other major currencies of the world. It is widely used to hedge risk in the currency markets or to take a position in the US Dollar without having the risk exposure of a single currency pair.

...  
The US Dollar Index allows the fx trader a feel for what is going on in the FX market globally at a glance. If the Dollar Index is trending lower, then it is likely that a major currency that is a component of it is trading

higher.

[Continue reading...](#)



In the assessment modules of [Practice Chapter A](#), a lot of questions will be drawn on this material. Don't be afraid to practice with them as many of the questions show extra explanations at the fulfillment of the assessment.

## 2. Measuring The Trade

### The Spread

As with other financial instruments, there is a price an investor can sell at which is called "**bid**" price, and a price the investor can buy at which is called "**ask**" price.

From the broker-dealers' perspective, the [bid](#) is the price at which the broker-dealer is prepared to buy, therefore to "[bid](#)" a specific currency pair from you as a trader. At this price, you can sell the [base currency](#) to the broker-dealer.

For example, in the [quote](#) EUR/USD 1.2872/73, the bid price is 1.2872. This means you sell one Euro for 1.2872 US Dollars.

In turn, the ask is the price at which the broker-dealer is prepared to sell (is "asking" for) you a specific currency pair. At this price, you can buy the [base currency](#). It is shown at the right side of the quotation. Sometimes it's also called the "offer" price.

Using the same EUR/USD [quote](#), the [ask price](#) is 1.2873. This means you can buy one EUR for 1.2873 US Dollars. The [ask price](#) is also called the [offer price](#).

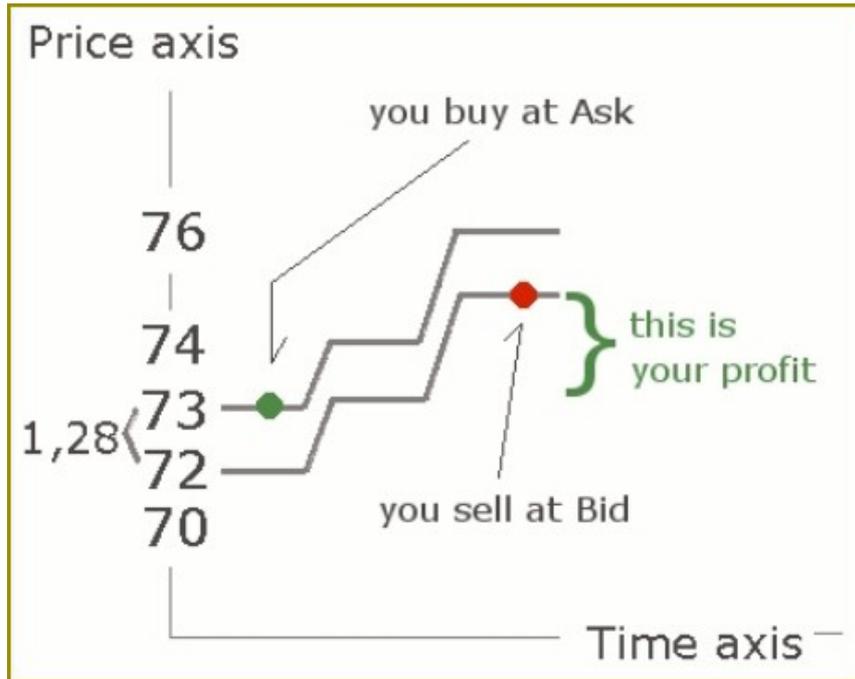
The difference between both prices is known as the "bid-offer spread" or "the spread", and it's expressed with a similar [quote](#) convention than the pair:

Bid / Ask

In our example, the spread value would be of 1 point, the difference between 1,2873 (the price the broker-dealer is ready to sell) and 1,2872 (the price the broker-dealer is ready to buy at).

So to summarize:

Example: EUR/USD  
1.2872/73  
Ask Price: 1.2873  
Bid Price: 1.2872  
Spread: 1 point



Another example illustrates that the bid price of the AUDUSD pair is 0,6520 USD and the [offer price](#) is 0.6528 USD:

$$\text{AUD/USD} = 0.6520/28$$

The critical characteristic of the [bid](#)/ask spread is that it is also the transaction cost for a round-turn trade.

The formula for calculating the transaction cost is:

$$\text{Transaction cost} = \text{Ask Price} - \text{Bid Price}$$

The spread in this case is made of 8 points, also called "[pips](#)".



The "big figure [quote](#)" is the interbank expression referring to the first few digits of an exchange rate. Sometimes you see these digits being omitted in certain dealer [quotes](#). For example, the above AUD/USD rate would be shown without the first three digits, as "20/28".

The spread is usually lower in the majors, since a high turnover assures ample [liquidity](#) to meet the trading needs. That is why interbank and retail dealers charge less for the majors through the spread. For less traded pairs or cross currency pairs the spread will be bigger, since at an interbank level these trades may involve the use of synthetic pairing and dealers have to assume more risk in completing those transactions.



If you intend to trade very short-term, i.e. with a tiny time horizon for each [round turn](#) trade, you will face a disadvantage in terms of trading costs because you will have to overcome the spread more often. This is the case of the so-called [scalpers](#).

To sum up 1000 [pips](#) trading the EUR/USD, a medium or long-term trader can make one or two trades that move that amount of [pips](#). Assuming an average spread of 2 [pips](#), the trader has to make 2 or 4 [pips](#) to overcome the spread.

To reach the same amount of [pips](#) with a [scalping](#) method, let's say with 50 [round turns](#), and assuming the same average spread on the EUR/USD, the cost will be of 100 [pips](#) (50 trades x 2 [pip](#)-spread). In terms of costs that's a lot of [pips](#) less effective than a long-term trader!

The spread can be considered an opponent when trading, and pairs with larger market spreads are suited for long term trading strategies. Think that before being profitable, any trade has to overcome the spread first- which is easier to achieve with narrow spread pairs.

Following the spread discussion we started in the previous chapter about fixed and variable spreads, Hans Nilsson adds some interesting points in his article "Quiet versus Volatile Markets, What Kind of Trader are You?"



Variable spreads may be more suited to long-term traders who do not trade during news events and are prone to entering and exiting during quiet market conditions. This way they can more consistently obtain a price that is in the lower range of the variable spread. For example, if a trader were to enter the market during off-peak times with a variable spread of 1 or 1.5 [pips](#) on EUR/USD as opposed to the fixed 2 or 3 [pip](#) spread on many platforms, he would save money on the spread in the long run.

- 100 trades at 1 [pip](#) (or 1.5 [pips](#)) = \$100 (\$150) in spreads
- 100 trades at 2 [pips](#) (or 3 [pips](#)) = \$200 (\$300) in spreads

However, flat markets and off-peak times are periods of consolidation when it is less clear where the price will head next. Most traders prefer to place positions when a clearer direction is evident in the market.

During swift market activity, especially around important fundamental releases such as a speech by a [central bank](#) official or the opening of local business hours and stock exchanges, spreads are widened to the upper part of their ranges. Likewise, during breaks of key technical levels, the market may also be very volatile sometimes moving as much as 100 [pips](#) in as little as 5 minutes. During these vulnerable times, opening positions become more expensive, which can be a deterrent to trading.

Consider this example: A trader prefers to enter and exit the market more when it is reacting to key news and events. He opens 100 positions of EUR/USD; he places 20 trades at a spread of 1.5 [pips](#), 20 at 2 [pips](#), and 30 each at 5 and 8 [pips](#), when the spread has widened to the upper part of its range.

- 20 trades at 1.5 [pips](#) = \$30 in spreads
- 20 trades at 2 [pips](#) = \$40 in spreads
- 30 trades at 5 [pips](#) = \$150 in spreads
- 30 trades at 8 [pips](#) = \$240 in spreads
- 100 trades at avg. (4.6 [pips](#)) = \$460
- All together the 100 trades cost \$460.
- 100 trades at fixed 2 [pips](#) = \$200 in spreads.

With a fixed spread those same trades would have amounted to a cost savings of \$260. This is a very simple case, but highlights the point that it depends a lot on the kind of trader you are and if you prefer trading during busy fast moving markets or times when the market is calmer.

Variable Spreads and Stops

Variable spreads may even set off protective stops and limits unwittingly. If the difference between the [Bid](#) and Ask widens and reaches the level of a stop or limit, this large [gap](#) may suddenly execute a conditional order. This adds an extra variable to your strategy that you need to consider. This might be less likely to occur with fixed spreads because the [Bid](#) and Ask are always synchronized. Fixed spreads minimize the element of surprise; traders know exactly what the parameters are at all times, allowing for better strategic planning and money management.

[Continue reading...](#)

## The PIP

In equities or futures, the smallest unit of measurement is called "tick" or "point". In Forex this unit is called a "[pip](#)" (for Percentage In Point). As shown in the most trading platforms a [pip](#) is the 4th decimal place after the comma or, which is the same, the ten-thousandths place in the quoted exchange rate (0.0001).

A well known exception is any currency pair that contains the Japanese Yen where a [pip](#) is the 2nd decimal after the comma (0.01). The same happens with the Thai Baht.

The reason to establish a common incremental unit in Forex is due to the fact that differently to equities which are all quoted in the same currency, in Forex each currency can be quoted in any other currency. That makes sense, doesn't it?

**If the exchange rate of a currency pair moves from 1.3000 to 1.3010, we say that the price moved up 10 [pips](#). The [pip](#) incremental is what shows if a position is winning or losing. So you make money when the [pips](#) move in your favor in a trade.**

An increment of a single [pip](#) has a certain value and in the case of direct-[quote](#) pairs (pairs quoted in US Dollars) that value is 10 US Dollar per standard lot, and 1 US Dollar per mini lot. Other currency pairs, like reverse [quote](#) pairs (with the USD being the [base currency](#)), and cross rates (pairs without the USD) will have different [pip](#) values.



If the pair ends in USD it's easy to deduce the [pip](#) value. If not, you will need to refer to a [pip](#) calculator to obtain the value, since these per [pip](#)

values can vary in time even within the same currency pair. You can use our [pip calculator](#).

Despite the fact that there are online calculators and that most of the platforms do the math for you, knowing how the [pip](#) value is calculated is something that really matters in your risk management. In order to calculate how much one [pip](#) is worth, the following information is needed: the trading size and the actual exchange rate of the pair to be traded. Moreover you may need the exchange rate of your account's currency to the US Dollar. Let's see some practical examples.

The formula to calculate the value of a [pip](#) can be divided into three categories:

## 1. Currency Pairs With Direct Quote (EURUSD, GBPUSD)

For currency pairs with direct [quote](#) the [pip](#) value is constant and doesn't depend on the current exchange rate of the pair being traded.

$$\text{pip value} = (\text{lot size}) \times (\text{pip size, with the corresponding decimal location} / \text{exchange rate})$$

where the exchange rate is always the [ask price](#).

Here is an example with the EUR/USD with the [quote](#) being 1.2599/1.2600.

$$€ 100,000 \times (0.0001 / 1.2600) = € 7.93 = 1 \text{ pip}$$

However, to get the value of the trade in Dollars, then multiply € 12.6 by the current EURUSD [quote](#):

$$€ 7.93 \times 1.2600 = \$ 9.99 (\$ 10.00 \text{ rounded up})$$

This phenomenon is observed when the Dollar is the counterpart or [quote](#) member within the pair: the [pip](#) value is always the same.

In the above example, a EUR/USD standard lot represents 100,000 Euro which can buy 126,000 US Dollars at the exchange rate of 1.2600. Therefore, the EUR/USD currency pair could be expressed as **100,000 EUR / 126,000 USD**.

If you buy the EUR/USD and it moved up by one [pip](#) to 1.2601 you have earned \$10. You can see the difference by subtracting the pair as **100,000 EUR/126,010 USD**. The amount of USD has grown on the right side of that equation by \$10- the value of the [pip](#).

## 2. Reverse Quote Pairs (USDJPY, USDCHF)

For those pairs having the USD as the [base currency](#) the [pip](#) value measured in Dollars is calculated with the same formula as with direct [quote](#) pairs:

$$\text{pip value} = (\text{lot size}) \times (\text{pip size} / \text{exchange rate})$$

However, in reverse [quote](#) pairs the [pip](#) value in US Dollars changes depending on the current [quote](#).

For example, exchanging a standard lot with the pair USD/JPY at the rate 107.00, the [pip](#) would be worth:

$$\$ 100,000 \times (0.01/107.00) = \$ 9.346 = 1 \text{ pip}$$

In these cases you don't need to exchange the [pip](#) value to US Dollars in order to get the [face value](#) of the trade, because the lot size is always in the [base currency](#) and so is the [pip](#) value.

## 3. Cross-Rates (GBPCHF, EURJPY etc.):

The [pip](#) value measured in Dollars in cross currency pairs is a little trickier.

For example: with the EUR/NZD rate representing 1 / 2.5040, or expressed in a standard lot, 100,000 EUR / 250,400 NZD at the current exchange rate, if the pair moves up one [pip](#) to 2.5041 then the position would have incremented 5,03 US Dollars per [pip](#).

Too abstract? Alright, this is the formula:

$$\text{pip value} = (\text{lot size}) \times (\text{pip size}) \times (\text{base exchange rate} / \text{exchange rate})$$

where the **base exchange** rate is the current quote of the base currency against US Dollar, and the **exchange rate** is, like in the previous formulas, the current quote of the traded pair. Therefore:

$$€ 100,000 \times 0.0001 \times (1.2600 / 2.5040) = \$ 5.03 = 1 \text{ pip}$$

For cross-rates the pip value is changing depending on the current exchange of the traded pair **AND** the base currency exchange rate to the US Dollar. Got it? Great!

The formula seems complicated because we are converting it to US Dollars. But if your account is in EUR and the traded pair is the EUR/NZD, then you don't need to input the base exchange rate in the calculation. Supposing you buy a standard lot of EUR/NZD, the value of the pip is:

$$€ 100,000 \times (0.0001/2.5040) = € 3.99 = 1 \text{ pip}$$



The exchange rate fluctuates, so does the value of the pip! Despite being just a small nuance, this is one of the factors that accounts for changes in the behavior of a currency pair over time. The more expensive the value of a pip, the more cautious will traders be with that particular pair. That is why the value of the pip has an influence on the price action.

For professional investors trading large amounts paying 1 or 1.2 Dollar per pip can make a huge difference.

Now you know how to combine the two concepts of pip value and lots. Important to recall once more:

- a) When you buy or sell a pair to enter a position, the face value is calculated in the base currency, the first within the pair.
- b) When you close and exit a position, the win or loss depends on the amount of pips and on the pip value. The profit or loss is initially expressed in the pip value of the quote currency (the second). To determine the total profit or loss, you must multiply the pip difference between the open price and closing price

- by the number of units of the currency traded.
- c) The [pip](#) value can be calculated in different ways depending if the traded pair is a direct rate (pairs quoted in US Dollars), a reverse rate (with the USD being the [base currency](#)) or a cross rate pair (pairs without the USD).



Your broker-dealer might have a different convention for calculating the [pip](#) value relative to the lot size. Check it out while testing the platform.

As each currency has its own value related to another, it's important to take these factors into account to refine the money management at an optimal level. Supposing you were planning similar trades on the GBP/USD, the GBP/JPY and the EUR/GBP with the rates as of January 2009. The [pip](#) values expressed in US Dollars would be approximately:

GBP/USD (1.4700): \$ 10  
 GBP/JPY (134.00): \$ 10.74  
 EUR/GBP (0.8700): \$ 14.67

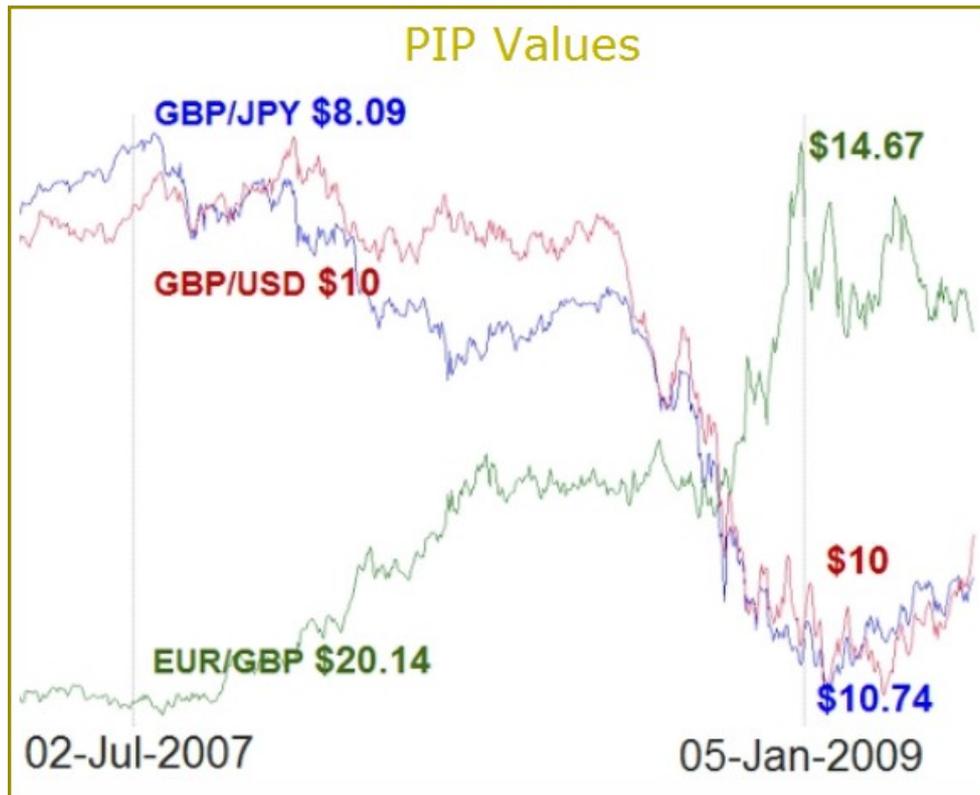
where the value in brackets is the [ask price](#) of the exchange rates of January 2009.

In this scenario you should account for the fact that a 100 [pip stop loss](#) or 200 [pip](#) target trading the GBP/USD accounts for 46% more than in the EUR/GBP because of the difference in [pip](#) values.

If we take the rates in, let's say, July 2007, the differences were even greater:

GBP/USD (2.0150): \$ 10  
 GBP/JPY (247.00): \$ 8.09  
 EUR/GBP (0.6700): \$ 20.14

At that time, there was a huge difference of more than 50% in the [pip](#) value (expressed in US Dollars) between the GBP/USD and the EUR/GBP. By comparison with January 2009, trading the GBP/JPY was cheaper in July 2007 in terms of [pip](#) values, while trading the EUR/GBP was more expensive. The image below shows line [charts](#) for the three pairs and the corresponding [pip](#) values.



Depending on your account size, trading one pair or the other will bring a different volatility to your account balance. In fact, the [pip](#) value serves to fine-tune the value of a trade by measuring what your possible profits and risks are worth. Another aspect to consider is that when the [pip](#) value is lower in one pair than in another, the risks that market participants are willing to take in this pair are probably wider in terms of [pips](#). This may increase the daily range of certain pairs or the placement of stop [orders](#) as we will see further in this chapter.

**The bottom line is that you could be taking riskier positions unintentionally if you don't know how to consider the [pip](#) values.**



### How large should an order be to move the EUR/USD by 1 pip?

There is really no exact way to measure the amount of capital necessary to move a pair by one [pip](#). It's not so the volume which moves an exchange rate, but a clear imbalance between the [demand](#) for a particular currency and its supply. The EUR/USD rate may require less capital to be moved during the Asian session as the market for these currencies is thinner compared to the New York session. Indispensable reads to unveil the mystery of price mechanics are the articles "[Price Mechanism](#)" at Wikipedia and Richar Olsen's "[Pricing in the FX Marketplace](#)".

In terms of risk management the lesson is not over yet! In order to calculate the real value of the trade you are now able to consider trading costs such as spreads or commissions and the [pip](#) value. But there is another intrinsic aspect of the Forex market to be considered: interest rates.

## The Interest Rate (Rollover)

Forex traders make money either buying low then selling high, or selling high then buying low. Profits and losses are determined by the opening and closing prices and by the [pip](#) value as you have studied in the previous section. However, profits and losses will also be affected by the different interest rates of the currency pair - by when the trades actually settle and how long the position is held.

Rest assured that the importance of this topic can eventually represent an advantage to your trading. Let's proceed by recalling the concept of exchanging two currencies from the beginning of the chapter.

**Every currency trade involves selling one currency and buying another. This exchange is the same as borrowing one currency to buy another. Since every pair consists of two currencies representing two economies with two different interest rates, most often it derives in an interest rate differential in the pair. This differential will, in turn, result in a net earning or payment of interest.**

The interest that is earned or paid is usually the target interest rate set by the [central bank](#) of the country that issues the currency. More precisely, the interest rates used

are the short term overnight [LIBOR](#) and [LIBID](#) rates, because most of the spot trades are short term. These are typically set by the British Banker's Association and are changed on a daily basis.

Countries don't change interest rates often, therefore the interest earned or paid can change on a daily basis but will typically not change very much. So a trader does not have to worry about timing the market too closely on this subject.

The interest is debited (paid) on the currency that is borrowed, and credited (earned) on the one that is bought, so that each pair has an interest payment and an interest charge associated with holding the position.

This means that if a trader is buying a currency with a higher interest rate than the one he/she is borrowing, the net differential will be positive and the trader will earn funds as a result.

Depending which member currency within the pair has the higher interest rate, on some pairs a payment may be made if you are buying it, and a charge may be made if you are selling it. But on other pairs, an interest payment may be made by selling it and a charge occurs when buying.

Most Forex broker-dealers automatically roll over the positions from one day to the other until the trader closes the position - a process called, naturally enough, a "rollover". Practically all trading platforms adjust the rollover to your account automatically, so you do not have to calculate it. This **premium** can also be called using the terms "swap", "tomorrow-next," or "cost of carry".

The rollover is necessary to avoid the actual delivery of the currency. As spot Forex is predominantly speculative, most of the time traders never request the actual delivery of the currencies they trade. Besides, delivering the currency is almost impossible with the [leverage](#) effect, because there is usually not enough capital to cover the transaction.

**Since the amount of the rollover is determined by the interest rate differential, the greatest interest can be earned by buying the currency that pays the highest interest and selling the currency that charges the lowest interest.**



This concept is the basis of the so called "[carry trade](#)", where profits are derived from earning accumulated interest differentials rather than by trading.

This is one of the favorite subjects of James Cheng. Here is [a list of carry trade related articles](#) from his blog at Fxstreet.com.



Source: Fibo & Pip, [FXstreet.com](http://FXstreet.com)



If you are trading a strategy which relies on - or is sensitive to - interest differentials, you may consider opening an account specially for this strategy with the dealer offering the most consistently attractive premiums. Broker-dealers usually list those premiums and charge within their trading software or on their website.

Don't hesitate to call the broker-dealer and negotiate a more favorable interest rate.

Forex broker-dealers also charge some interest from the equation, so the exact amount of interest that you will earn or pay will vary from broker to broker.

Ask the broker-dealer's support team what it takes to get a higher rate. Remember, you are the client, you decide what to do with your money.



You don't know what the interest rates are for each currency? To see which countries currently have the greatest and lowest interest rates, and therefore identify the biggest differentials, you can check [this table](#).



In accordance with the Islamic religious law some broker-dealers offer a type of account especially intended to Muslims as swaps go against their religious beliefs. In such broker-dealer accounts, no rollover will be applied. The so called "Shariah Law" is based on Islamic principles which Muslims are expected to follow in the various aspects of their daily living including banking and finance, and forbids all forms of interest. Please refer to our [Arabic site](#) to contact your Shariah law compliant Forex broker.

In the spot Forex market, delivery of the underlying is immediate as opposed to forward delivery. But as briefly explained in [Chapter A01](#), the delivery is technically a two-day maturity transaction. This means that the exchange of funds, also called "**settlement**", takes place two business days after the entry date- the date when the trade has been accepted by the broker-dealer. The date of settlement is known as the [value date](#) or delivery date, as it refers to the date on which the foreign exchange deal is due to mature. Rollovers, in effect, continually delay the actual settlement of the trade until the trader closes his/her position.

Settlement for most pairs, often depicted as **T+2**, takes 2 days because most of the transactions are made between continents with different time zones. The exception are North American currency pairs, comprised of USD, CAD or MXN (Mexican peso), whose settle is 1 [good business day](#) (T+1).

As explained before, the net interest is either added or deducted from the trader's account at the end of each trading day as long as the position is open. Because currency trading is a 24-hour global market, there needs to be an agreement as to what constitutes the end of the day. By convention, the broker-dealer's settlement time or "cut-off time" is 5 P.M. Eastern Standard Time (EST) or 10 P.M. GMT in winter or 9 P.M. GMT in summer.

The reason this particular time is used is because according to the International date line, when it is 5 P.M. in New York, it's Monday morning in Australia and New Zealand hence it marks the beginning of a trading day and week.

At the settlement time (5P.M. EST), a new [good business day](#) starts. So for any trade opened at or after 5 P.M. EST on Monday, the trade day will be considered Tuesday. For a trade opened at latest 4:59 P.M. EST the trade day is still the day of the opening of the trade.

With these conventions in mind we can now deduce that a trade in EUR/USD opened at 2 P.M. EST Monday would settle on Wednesday at 5 P.M. because the trade day would be still Monday, and 2 full maturity days later is Wednesday at 5 P.M. EST. because the trade day would be still Monday, and 2 full maturity days later is Wednesday at 5 P.M. EST.

However, if the same currency pair were to be traded after 5 P.M., let's say at 8 P.M. on Monday, then the trade day would be Tuesday and the [settlement date](#) would be Thursday at 5 P.M. EST.

Moreover, for a T+2 currency pair that was traded after 5 P.M. EST on Wednesday, the trade date is Thursday. Now, if we add 2 [good business days](#) it would settle on Saturday. But because the market is essentially closed on Saturday and Sunday, the value is extended to Monday.

Since interest is calculated for every day while position is held, including weekends and holidays, the amount of interest credited or debited depends on the number of days between rollovers. If the rollover period is extended because of holidays, then the additional holidays are counted as well. This can lead to several days especially at the end/beginning of the year.



For trades opened on Wednesdays after 5 P.M. (or Thursday for a T+1 currency pair), the interest premium is triple the normal amount because there are 3 days instead of just 1 day between rollovers! That can have a negative impact in your trading costs, but if you pick deliberately a pair with a very high positive interest rate differential, this can act to your advantage. Very few traders consider these small nuances into their trading, but at the end of the year, they can represent a notable difference in your overall performance.

By the same logic, if you do not want to earn or pay interest on your positions, simply make sure they are all closed before 5 P.M. EST, the established end of the business day.

There are basically two ways that broker-dealers use to pay or charge this premium. One is through an actual payment or charge to your account balance, the other is by resetting and adjusting your position in a more or less favorable price depending if the rollover is positive or negative.

This process of resetting your position means simultaneously closing and opening it, so that if you are owed a premium your entry is reset to a lower entry price on a buy trade. Likewise, when selling and owing a premium, your entry price will be reset to be slightly higher, that means a less favorable one than it was originally.

On most trading platforms the premium is clearly visible on the control panel and also in the account statements. As mentioned before, many trading platforms or broker-dealer's websites will also show the amount of positive or negative rollover for each currency pair that can be traded, thereby informing the trader beforehand of the interest rate differential.

Also note that many retail broker-dealers do adjust their rollover rates based not only on the [LIBOR](#) short term rates, but also on your account [leverage](#) and account type. That is why you should check your broker-dealer on rollover rates and crediting/debiting procedures.



You may find that your broker-dealer is paying you a little less and charging you a little more than you may have expected if you calculate the rollovers by yourself. That means they are taking a portion of this premium as part of their service charges. Again, in order to avoid unnecessary pitfalls, check everything out before opening a real money account.

Still another issue: while it is common for these payments to be made around the end of a [good business day](#) at 5 P.M. EST, a few dealers may spread the premium into a continuous payment while the position remains open.

Now we are going over the rollover a little more in depth so that you understand how it is calculated - despite being an automated process in most cases.

As an example we will take the pair AUD/USD, which has been for a long time the one with the greatest rollover differential.

Imagine that you are long one mini lot on the AUD/USD and the current interest rates as defined by the overnight rate is 7.60% and 4.20% respectively. In order to net those two interest rates we calculate:

Rollover AUD/USD Buy =

$$((\text{LIBID USD} - \text{LIBOR AUD}) \times \text{Lot Size}) / 100\% / 365$$

where 365 is the number of days in a year.

The formula explained in several steps is:

- First you calculate the difference between the overnight interest rates of the two currencies involved in the pair:

$$(7.60 - 4.20) = 3.4$$

Sometimes here you have to subtract a small percentage which is the portion that charges the broker-dealer for the service.

- Second, the difference between the two interest rates has to be multiplied by the amount of the [base currency](#) held in the trade:

$$((3.4) \times 10,000 \text{ AUD}) = 34,000 \text{ AUD}$$

- Divide that amount by 100 (%) and then by 360 days to arrive at a close approximation of the interest premium payment in the [base currency](#) per day:

$$34,000 \text{ AUD} / 100 / 360 = 94.44 \text{ AUD}$$

- If the [base currency](#) of the position you hold is different from the currency you hold your account in, convert it to your currency multiplying the above result by the current rate between the [base currency](#) and your account currency.

$$94.44 \text{ AUD} \times 0.8455 \text{ (AUD/USD)} = \$ 79.84$$

If you were short the AUD/USD you would reverse the first part of the equation and find the amount you should be charged to be holding that position.

$$((- \text{LIBOR USD} + \text{LIBID AUD}) \times \text{Lot Size}) / 100\% / 365$$

An interesting aspect you can observe in the above calculation is that when borrowing and buying currency [lots](#), the net premium, either positive or negative, is calculated in accordance to the size of the position.

Usually the trader has leveraged amounts of capital because the transactions, and the broker-dealer pays or charges a premium accordingly that amount of capital. That is why the rollover is dependent on the [leverage](#). This is the next subject to understand the mechanics of trading.

In an educational and entertaining way, Rob Booker explains the interest differential process through carry trading, in the words of Harry Banes



I pulled out my notebook? and flipped open to the tab I'd marked "Interest Rates-Retail [Carry Trade](#)." Then I began: "You talked about borrowing cheap money and then investing in high-interest currencies. I sat down for at least two hours and learned why it works. It makes perfect sense to me. A high-rated borrower has, in effect, a huge pool of capital to draw from. I realized that a wise investor should always look to borrow at the lowest rates and invest for the highest rates possible, combined with a reasonable expectation of return. I hadn't ever consider that, not because it doesn't make sense, but rather because it's just not something I would have thought about."

George smiled. "And now that you thought about it, what did you learn?"

"I learned that carry trades don't just invest in currencies. They also invest in US stocks, bonds from around the world, real estate, they even purchase entire companies with the borrowed money. There is a whole lot of borrowed Yen out there. But I will get to that point later. I am sure I am not telling you anything that you don't already know."

He nodded. "Probably true. But I have thirty minutes and I want to hear it all again."

I looked down over my notes. There was no possible way for me to get through everything in half an hour. But I plodded onward: "Once I had an understanding of why it worked, and believe me, it took me a while to figure it out, I realized that I could try to apply the same principles in my currency trading. I called my currency dealer and asked about interest rates. It turns out that retail currency platforms charge or pay interest in the same way that a bank would charge or pay interest. Only retail platforms call it a swap rate, and the interest is calculated at the end of every currency trading day - in other words, at five P.M. Eastern time."

"How much are they charging or paying out?"

"Well, for my research here, I used the British Pound versus the Japanese Yen, the GBP/JPY. Because interest rates in Japan are at zero, and rates in the United Kingdom are at 4 percent- and, I might add, expected to keep rising-when I buy one standard lot of the GBP/JPY cross pair in my trading account, which is \$100,000 worth of currency, I get paid about \$20 every day in interest."

"What kind of [leverage](#) do they give you?"

"That's my next point. I have 400:1 [leverage](#) with my dealer, which I know sounds ridiculous. It's a ton of [leverage](#). But the [leverage](#) is almost

irrelevant," I told him, "and this is where it gets exiting. I hope I haven't gone totally wrong with this research, because I think I stumbled onto something really amazing.

"Let's say that I open an account with Universal Currency Brokers. I put \$100,000 in the account. I don't have that much money, but let's just say I do. I put up only \$10,000 of that money for margin. And because of [leverage](#), they let me buy \$4,000,000 worth of GBP/JPY, or forty standard [lots](#). Every day that I hold that currency, I get paid \$20 for every standard lot, or \$800. Just for holding onto the currency pair in a buy position. This sounds too good to be true, but I called around that night to at least 20 currency dealers. I found out that almost all of them are paying interest in those amounts. Almost all of them. I hope I'm okay so far."

George nodded. He looked at his watch. I could tell that I had captured his interest. He said: "I ordered in some sandwiches but I'm losing my appetite while you talk to me about money."

"Me too, I can eat later."

"Good. So far, this is fine research you've done. This is slightly different than the way it works for us, but it's perfect so far."

"I'm happy to hear that. If the research was faulty up to this point, I'd have nothing left to say. But here's what comes next: I thought, it sounds too easy to just buy the GBP/JPY each day and try to earn \$800. Why? Because the currency pair might fall, instead of rise. You know, if some news comes out, or if there is a terrorist act, the currency pair is going to bounce around. And for each standard lot traded, a [pip](#) is worth about nine Dollars. Say it drops 100 [pips](#), and I've traded 40 standard. If the pair falls 100 [pips](#) in one day, I would lose 100 times nine Dollars times forty- that's 100 [pips](#), times nine Dollars per standard lot, times forty standard [lots](#) traded. That's a lot of money. Way more than I would be earning from the interest."

"It's just not worth the risk then," he added.

Source: [Adventures of a Currency Trader, A Fable about Trading, Courage and Doing the Right Thing, Rob Booker, John Wiley & Sons, Inc., 2007, p.176-177](#)

### 3. Margin and Leverage

#### Lots and Position Sizes

In Forex the minimum amount of currency you have to buy is called one "lot". That means that units of currencies are grouped and traded in [lots](#). At a retail level, [lots](#) are divided into several categories: the so-called "full-size" or "standard" [lots](#), "mini" [lots](#), "micro" [lots](#) and "flexible" or "fractional" [lots](#).

A standard lot consists of 100,000 units of whatever the [base currency](#) in the currency pair is. A mini lot consists of 10,000 units of the [base currency](#) and a micro lot 1,000 units of the [base currency](#).

As you can see, a mini contract is one-tenth the size of a standard contract and the micro lot one-tenth of the mini lot.

Flexible [lots](#), in turn, allow the trader to choose the exact amount of units of the [base currency](#) to buy or sell.

Differentiated by the lot sizes there are also several types of accounts that a trader can open with a retail broker-dealer. While a [standard account](#) controls 100,000 units per lot traded, a [mini account](#) and a [micro account](#) control one lot size lower respectively.

So for instance, when buying one micro lot on the GBP/USD, you would buy 1,000 British Pounds and sell an equivalent amount of US Dollars.

Let's suppose the current exchange rate for GBPUSD is 2.4500 and you want to buy 10,000 US Dollars worth of this pair. Here's the math:

For pairs with USD as the [quote](#) currency, take the Dollar amount you want to purchase and divide it by the exchange rate:

$$(\text{desired position size}) / (\text{current rate}) = \# \text{ of units}$$

that is:

$$10,000 \text{ US Dollars} / 2.4500 = 4081.63 \text{ units of GBPUSD}$$

As you can see, this is approximately 4 mini [lots](#) of British Pounds. If your broker-dealer doesn't offer fractional lot sizes you can always round up or down.

Buying a pair with USD as the [base currency](#) is much easier to calculate. Why? Because in these cases you just buy the amount of units you want because you are purchasing US Dollars, the [base currency](#).

And in the case of a cross pair transaction, when buying 10,000 US Dollar worth of GBPCHF, for instance, we purchase 4081.63 units of GBPUSD at the above rate and sell 10,000 units of USDCHF.

**Being able to choose among several lot sizes is a huge advantage retail Forex trading offers to the small investor. It allows you to tailor and fine tune your money management to better meet your trading style.**

If you have a very small account size keep your risk profile low by choosing a dealer that offers micro or fractional lot sizes. Even many seasoned traders avoid standard contracts to be more precise in their position sizing. We will extensively talk about position sizing and money management in other units of the Learning Center.



**Can I still trade currencies if the lot sizes are much superior to my account size?** Yes. And not only that: by trading whatever size of [lots](#) you will gain or lose profits as though that money was in your account. Making use of the [leverage](#) effect permits a trader to control a large amount of capital with a comparatively small amount of capital. This is called margin trading.

Nevertheless, margin trading is a double-edged sword: it can lead to large gains but conversely it can cause large losses if the exchange rate moves against the anticipated direction.

## The Concept of Leverage

A very extended and poor definition of [leverage](#) is that it's a tool that will help traders earn money fast and easy. And indeed, one of the most important advantages of the Forex market is given by the effect of [leverage](#)! Without [leverage](#), it would be very difficult to accumulate capital by trading the market, especially for small investors. But [leverage](#) can also be very harmful if not properly understood. This duality is what makes this concept difficult to grasp and explains partly why there are so many misconceptions about it.

Financial [leverage](#), meaning a purchase on a margin, is the only way for small investors to participate in a market that was originally designed only for banks and financial institutions. [Leverage](#) is a necessary feature in the Forex market not only because of the magnitude of capital required to participate in it, but also because the major currencies fluctuate on average less than 2% per day.

Without [leverage](#), the Forex would not attract capital from the retail sector. It is designed to allow a greater market share to investors in accordance with their investment capacity.

Leverage is therefore a form of credit or loan, which allows us to trade with money from the broker-dealer. Financial [leverage](#) is also defined as the use of foreign capital per unit of capital invested.

In fact, the mechanism of [leverage](#) is what enables the existence of broker-dealers. They also have accounts in different banks which serve them as [liquidity](#) providers, thus acting as lenders of first resort for the broker-dealer's margin transactions. This means that the bank allows the broker-dealer to trade with larger amounts of capital and the broker-dealer, in turn, transfers this benefit to the user. The capital deposited in the bank guarantees limited risk, as does your deposit with the broker-dealer.

## Margin Trading

When conducting a Forex transaction, you are not actually buying all that currency and depositing it into your account. Technically, you are speculating on the exchange rate and contracting with your broker-dealer that they will pay you, or you will pay them, depending if the exchange rate moves in your favor or not.

A trader who purchases a USD/JPY standard lot does not have to put down the full value of the trade (100,000 USD). But to gear up the trade size to institutional level, the buyer is required to put down a deposit known as "margin". The minimum deposit capital varies from broker to broker and can range from \$100 to \$100,000. That is why margin trading can be seen as trading with borrowed capital– it's basically a loan from the broker-dealer to the trader, but based on the trader's deposited amount. Margin trading is what allows [leverage](#).

In the above example, the trader's initial deposit serves as a guarantee (a collateral) for the leveraged amount of 100,000 USD. This mechanism insures the broker-dealer against potential losses. As you see, you are not using the deposit as a payment or purchase of currency units. It is rather a good-faith deposit, made by the trader to the

dealer or broker.

When executing a new trade, a certain percentage of the deposit in the [margin account](#) will be frozen as the initial margin requirement for the new trade. The quantity of required margin per trade depends on the underlying currency pair, its current exchange rate and the number of [lots](#) traded. Remember, the lot size always refers to the [base currency](#). The frozen initial margin requirement may not be used in trading until the trade is closed.

The more positions are opened simultaneously the more margin is required until it eventually becomes a notable percentage of your account.



Many aspiring traders hope to make huge gains only with the help of [leverage](#), but in reality they are draining their accounts systematically. It's not a difficult thing to do: just open an account with \$1,000 and start trading by opening a position, let's say, in the USD/CAD with a size of 3 mini-[lots](#) (\$30,000). In the case the position loses 100 [pips](#), the account will be left with \$700.

Now you may feel tempted to recover the previous loss with a 50 [pips](#) gain trading with 6 mini [lots](#). But if the trade loses another 50 [pips](#), you will have lost \$300. With the remaining \$400, you may think in recovering the initial deposit trading 4 mini [lots](#), and go for 150 [pips](#), and so on... With each loss a recovery becomes less and less feasible because of the increase of [leverage](#).

**Leverage is the main reason why so many novice traders (and not so novice) are swept from the market. Combining their small accounts with ultra high leverages, they are an easy prey for the less leveraged and professional traders.**

The belief that [leverage](#) can offset losses with big gains leads many aspiring traders to increase [leverage](#) when they experience a series of losses. Typically, the account will suffer a substantial loss. When these losses drain the account to less than the minimum [margin account](#) level, the broker-dealer will close the position and leave them with whatever is left in the account. This is how to "blow up" an account.

## Margin Call - a Guaranteed Limited Risk

In the [futures market](#), a losing position may go beyond the deposited margin, and the trader will be liable for any resulting deficit in the account. In Forex this will not

happen as the risk is minimized through the mechanism of a "[margin call](#)".

Most online trading platforms have the capability of automatically generating a [margin call](#) when your margin deposits have fallen below the required minimum level because an open position has moved against you.

In other words, when the losses exceed the deposit margin, all open positions will be closed immediately, regardless of the size of positions held within the account.



Because you can never lose more than what you have deposited in your brokerage account doesn't mean that you don't have to manage your risk. It's important to take time to understand the risks associated with margin trading. Make sure you fully understand the mechanism, and in case there is anything unclear to you, be sure to ask your broker-dealer about its margin conditions.



**Can the available balance be used as margin to open further positions?**

Usually broker-dealers allow you to use your available balance (deposit +/- open trades) as a collateral to open further positions, allowing thus to use as further margin those funds from unrealized positions in benefit. This strategy has its inherent risks because a reversal in your positions, turning them into negative territory, can rapidly originate a [margin call](#). Should a [margin call](#) occur, make sure that you are left with more capital in your account balance than what you had before opening the positions. You can manage your positions in such a way that despite of a [margin call](#) you are left with more capital than in the beginning. For more advanced lessons on position size optimization, please see [Chapter C03](#).

## Leveraged Trading

Trading currencies on margin lets you increase your buying power. If you ask your broker-dealer what their margin requirement is for a standard lot they will give you a relatively small amount, typically \$1,000. When you trade with \$5,000 in margin and you control 5 standard [lots](#) worth of \$500,000, that's a 100:1 [leverage](#), because you only have to post one percent of the purchase price as collateral. This means the trader has to have at least \$5,000 (\$5,000 + spread to be more precise) in the [margin account](#) to trade 5 full size [lots](#).



Now you understand why the rollover amount will depend on the size of the transaction: with higher leverages, the interest differential the broker-dealer pays or charges will proportionally increase, because you are controlling a larger amount of currency, even if you don't have that amount in your account.

The normal margin requirement is between 1% and 5% of the underlying value of the trade, that is a [leverage](#) between 100:1 and 20:1, although some broker-dealers provide extreme levels of 200:1 (0.5%) and more. Most dealers scale their margin requirements which allows smaller accounts to use higher leverages like 200:1, and bigger accounts to use 50:1, or 10:1.

The currency denomination for the [leverage](#) depends on the brokerage through which you execute your trade, but it is usually US Dollars.



Despite being very attractive for small investors, [leverage](#) is one of the main reasons people lose money trading Forex. The purpose and use of [leverage](#) can be a difficult subject to understand, but it's mandatory if you want to avoid the traps it may represent. It is not in your interest to misuse the concepts of margin and [leverage](#). Professional traders are very careful about it- that is why they stay in the market in the long term.

A common way to calculate the margin required per trade is the following: suppose you have 100:1 [leverage](#) from your broker-dealer. The maximum trade size is then calculated as amount in USD x 100. Supposing you decide to buy one standard lot of GBP/USD. To figure out the amount of capital which has to be set aside as margin for the value of the deal, we need to take the current rate for GBP/USD (let's say 2.0200) and do the following:

$$(2.0200 * 100,000)/100 = \$2020.00$$

Should the account balance equal or drop below the margin requirement, the broker-dealer would liquidate all open positions on a [margin call](#). That means that using \$2020 in margin and trading one standard lot with \$10,000 in the account, if the trade would go negative by \$7981, a [margin call](#) would occur.

IF ([margin account](#)) - (position value) < min. margin requirement

THEN



$$\$10,000 - \$7,981 = \$2,019 < \$2,020 \rightarrow \text{margin call!}$$

In reverse [quote](#) pairs, the currency denomination for the [leverage](#) is already in USD. In the case you would decide to buy a standard lot of USD/JPY at a rate of 105.00, then you would need a \$1,000 margin for a \$100,000 lot with a 100:1 [leverage](#).

Let's say you have an account with \$10,000 and you open that USD/JPY position. The broker-dealer won't automatically close the trade if the losses exceed \$1,000. The [margin call](#) will occur only when your net balance is less than \$1,000. So if the position goes against you and accumulates \$9,001 worth of losses, your position will be automatically closed and you will be left with \$999 in your account. Broker platforms already include the spread and the rollover into the equation, but

remember that these variables also influence the net balance.

Dirk Du Toit insists a lot on explaining this subject to his students. In his book, "Bird Watching in Lion Country", he states:



Margin required and [leverage](#) is not the same thing. "Low margins" = "low margin requirement" = "high gearing". You do not trade with 100:1 [leverage](#) or 1%. Your margin required is 1%. If you go broke your broker will allow you to trade up to 100:1.

Let me explain the problem with an example of half-percent margin. A prominent [market maker](#) offers "\$1.000" [lots](#) and "\$500" [lots](#). You have \$10.000 and you use 1% margin on the \$1.000 [lots](#). What's your percentage?

Write it down here \_\_\_\_ or hold the thought. You make \$300 Dollars on a trade and decide this is too easy. You arrange to pay the \$10.00 fee and trade on 200:1 [leverage](#) or "\$500 [lots](#)."

You have \$10.300 and you now use 1% margin on the \$500 [lots](#). What's your [leverage](#)? Write it down here \_\_\_\_\_ or hold the thought.

The total is \$1.000, still only 10% of your capital account required for margin, what's the problem?

The problem is that it is a false concept to express risk as a ratio of "margin required" to "capital on margin". It is an illusion that your risk was the same, yesterday and today.

Yesterday you traded \$100.000, i.e. you levered your money 10:1 (for each one Dollar you have you trade as if you have ten). Today you traded \$200.000, i.e. you levered your money 20:1 (for each Dollar you have you trade as if you have twenty). All it means is the time it takes for the guillotine to drop has been halved. You can be deceived by [lots](#) of \$1.000 and risking "only 10% of your capital". You don't risk only /10th of your capital, you risk your capital 10 times.

Source: [Bird Watching in Lion Country, Dirk Du Toit, e-book](#)



The Assessment modules in the [Practice Chapter A](#) contain more than 250 questions, and many of them insist on the issue of [leverage](#). These educational resources aim to train the trader for real case scenarios by applying the theory explained in the Learning Center.

## Effective Leverage vs. Maximum Leverage

On one hand traders can exploit the maximum margin requirements that the broker-dealer provides, which can range from 100:1 to 400:1, but on the other hand we have the technical aspect of the mechanism. When asking what [leverage](#) you are using in your trading, you have to refer to the leveraged amount which you are effectively using to enhance your trading strategy.

The effective [leverage](#) is of paramount importance. There is nothing wrong in choosing the maximum level of [leverage](#) that the broker-dealer allows. What can put a trader in a dangerous situation is when the effective [leverage](#) comes close to the maximum displayed by the broker-dealer.

**The effective [leverage](#) is calculated by dividing the value of open positions by the available balance of the account. In other words, the real [leverage](#) is the amount of capital you are really using compared to the amount in your account.**

With a position worth of \$20,000 (2 mini [lots](#)) and an account balance of \$1,000, the real [leverage](#) is 20:1 ( $20.000/1.000 = 20$ ). If this trade loses 50 [pips](#), the account balance would go down by 10%. Remember, the [pip](#) value would be \$2,00, multiplied by 50 [pips](#), that is \$100.

Should this loss happen, the real risk would increase with the next trade - now a loss of \$100 is 11% of the account. This also means that the effective [leverage](#) rises even if the position size is kept the same, because the account balance is now lower. This is the typical dynamic of a losing spiral we mentioned when traders blow up their accounts - by doing the same, they lose more with each trade. This is because [leverage](#) increases each time.

To compound the issue, if the trader increases his/her [leverage](#) deliberately thinking in recovering losses faster, he/she is not acting in his/her best interest.

A [leverage](#) of 20:1 in a single position is quite high if we are to stay in the market for the long run. If our method is efficient in terms of consistency, then we can fine tune the [leverage](#) to get the maximum profit from it. This doesn't mean to exploit the maximum [leverage](#) offered by the broker-dealer, but instead, to use the maximum [leverage](#) that our method can sustain without the danger of a [margin call](#).

For instance, you can have 5 open positions with an effective [leverage](#) of 4:1 each one. This way, you arrive at a [leverage](#) of 20:1 by adding 5 positions, and you will be eventually better protected with multiple positions over different currencies, than betting that leveraged amount in just one currency pair. The same [leverage](#) of 20:1

spread over several positions is a measure to diversify your risk.

How to bring this into practice will be discussed further when studying the development of trading systems and money management techniques. For now let's take one more step in the appliance of the mechanics you have just learned.



A lack of understanding of trading mechanics can lead you to damage your account unintentionally. Don't wait to be confronted with these fine aspects when incurring errors. Expose your doubts and share your experiences in the [Learning Center forum](#).

## 4. Types Of Orders

To complete your view on the trading mechanics, let's cover the different order types that allow you to enter, exit and program trades. There is a wide choice of [orders](#) designed for all types of trading styles.

### Market Order

Orders that are executed immediately at current rates are known as [market orders](#). For example, suppose GBP/USD is currently traded at 1.5842; if you wanted to go long at this exact price, you would click buy and your trading platform would instantly execute a buy order at that exact price.

When closing a position manually, the trader is also technically executing a [market order](#) of the same amount in the opposite direction of the open trade. To close a long GBP/USD position, the trader only has to go short the same size than the long position. This is also called an offsetting or liquidating transaction.



It's important to note that with most all broker-dealers, your profits and losses will be accrued in the currency you have your account in. For instance, if you exit a long USD/JPY trade, you are buying back Japanese Yen, but your profit or loss will be converted to the currency you have your account in with the broker-dealer, so you don't have to worry doing it.

### Entry stop order

An entry stop order is an order you can preset into the platform to buy or sell at a specified price. Supposing EUR/USD is currently traded at 1.1014. and you want to buy if the price reaches 1.1100. You can either monitor the exchange rate and enter a [market order](#) manually if it reaches that price level, or program an entry stop order at 1.1100. If the price goes up to that level, your trading platform will automatically

execute a buy order at that price.

The entry stop price on a buy order must be above the current ask (offer) and on a sell order it must be below the current [bid](#). Note that not all broker-dealers guarantee you an execution at or near the stop price.

Sometimes entry [orders](#) contain a second variable: time duration. Besides the price at which you wish to buy or sell a certain currency pair, you can also specify how long the order shall remain valid.



### **What happens if the broker can't find a match for a position? Do they take the other side of it?**

The dealer will take the other side of the trade when acting as a [market maker](#), otherwise it will process it through the [interbank market](#).

Depending on the size of the order the broker-dealer will be able to fill it or not. But usually broker-dealers can always find a match for your position as there is one [bid](#) and [ask price](#) but thousands of participants acting through their platform. In the event the broker-dealer can't fill the order at the desired price then [slippage](#) may occur. When there is no order to be matched with then the order will be re-quoted with the next possible value.

## Limit Order

It's an order to buy or to sell at a specified price executed at the limit price or at a better price than the market price. A sell [limit order](#) can only be executed at the limit price or higher, and a buy [limit order](#) can only be executed at the limit price or lower. Note that a [limit order](#) can possibly not be executed because the market price may quickly surpass the limit price before your order can be filled. This type of order is used as a protection from buying the currency at a too high price or selling at a too low price.

## Stop Loss Order

A stop loss order is a [limit order](#) preset to close out a position automatically when the

bid or offer price touches a given level with the purpose of preventing additional losses if price goes against you. In a long position the stop loss will be set below the spread, and in a short position above the spread.

A stop loss order remains active until the position is liquidated or you cancel the stop loss order. For example, if you go short USD/JPY at 107.00 you can limit your maximum loss by presetting a stop loss order at 108.00. This means if the exchange rate moves up by 100 pips, your trading platform would automatically execute a buy order at 108.00 and close out your position for a 100 pip loss.

If you have a long position instead, you may issue a stop loss order below the current exchange rate. If the market price falls through the stop loss trigger price, then the order will be activated and your long position will be automatically closed out.

Like limit losses, stop losses are useful if you don't want to sit in front of your trading platform all day. They also prevent you from losing more than what you intended to in the case the Internet connection fails or if you simply fall asleep.



Source: Fibo & Pip, [FXstreet.com](http://FXstreet.com)



A problem with stop orders is that exchange rates may move through the stop loss trigger prices in volatile market conditions, making stops impossible to execute at the preset levels. Not all broker-dealers guarantee an exact execution of the orders, and a so called "slippage" may occur. The market volatility hits extremes when key economical news are announced which can affect the exchange rates, and the probability for a slippage to happen rises if your stops are very tight.



Use your platform to place the stops, not your mind. This is a good advice especially if you are not an experienced trader. Not only a stop loss order is an electronic risk limiting device, avoiding such problems as mentioned above, but it is also a measure against your eventual doubts about the decision you took to enter the market.

You can always feel tempted to let a losing position go against you in the hope the market turns in your favor, but when that happens you are probably not solvent anymore because of the [leverage](#) effect. To avoid that harass, let the platform automatically execute your stop.

Margin calls, as discussed before, can be effectively avoided by monitoring your account balance on a very regular basis and by utilizing stop-loss [orders](#) on every open position to limit risk.

Below follow the main order execution mechanisms used in Forex trading:

## Trailing Stop Loss

A trailing [stop loss](#) is a stop loss order that is linked to a position like any [stop loss](#), but instead of being fixed at a certain price level, it has the capability to move as the position moves into profit. By raising the [stop loss](#) trigger price, partial gains on the position are locked in.



Note that stops can be manually "trailed", moving them strategically instead of automatically. That way, you can keep a stop beneath a strategic level, instead of moving it to an arbitrary location - which is often exactly what happens when using automatic trailing stops. There are certain price levels like round numbers (for example, 1.5400, 107.00 or 1.4000) or all time highs and lows where many positions are activated.

Stops placed close to these levels are more likely to get hit and executed.

## Take Profits Order (TPO)

The opposite of a [stop loss](#) (i.e. a stop gain). The TPO order specifies that a position should be closed out when the current exchange rate crosses a given threshold. For a short position, the TPO order will be set below the current exchange rate, and vice versa for a long position.

## Firt-in First-out (FIFO)

In Forex trading it refers to an order queue structure where all positions opened within a particular currency pair are liquidated (closed) in the order in which they were originally opened.

## Good Until Canceled (GTC)

Limit [orders](#) can be good for a specified time period (hours, days, months) or "good till canceled". A GTC [limit order](#) is held open indefinitely (unless filled) and is only terminated on instructions by the account holder.

A GTC order remains active in the market until you decide to cancel it. Your broker-dealer will not cancel the order at any time. Therefore it's your responsibility to remember that you have the order scheduled.

## Good For the Day (GFD)

A GFD [limit order](#) is held open for the balance of the trading day unless it is filled before then. A GFD order remains active in the market until the end of the trading day. Remember that the end of the day in Forex is usually 5P.M. EST, but in any case double check with your broker-dealer.

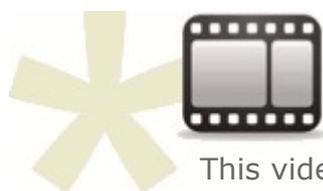
## One Cancels the Other (OCO)

An OCO order is a combination of two limit and/or stop-loss [orders](#) at opposite ends of the spread. Two [orders](#) with price and duration variables are placed above and below the current price. When one of the [orders](#) is executed the other order is canceled. Example: The price of EUR/USD is 1.0050. You want to either buy at 1.0100 in anticipation of an up move or open a sell position if the price falls below 1.0000. If 1.01005 is reached, the buy order is triggered and the sell order is automatically terminated.

You can also use this type of [orders](#) when already in an open trade. For example, if you are in a long position, the [stop loss](#) is placed below the entry price, right? In this case the OCO limit sell order would be placed above the entry price. If the [base currency](#) rate breaches the OCO trigger price then the position will automatically be sold and the original [stop loss](#) is canceled. Alternatively, if the rate falls to the [stop loss](#) threshold, then the position will be closed out for a loss and the OCO [limit order](#) terminated.



You may find different names for the order types herewith described as each broker-dealer has its own specifications and each platform its level of sophistication.



This video goes beyond the trading mechanics and aims to help you formulate a few questions regarding your motivations and expectations to become a trader. Enhancing your awareness about these subtle aspects will significantly [leverage](#) your know-how.



What you have learned from this chapter:

- Each currency has a different behavior tied to the economical and geopolitical conditions of the country issuing it.
- A margined account can be levered up, that is, currencies can be traded on cash collateral made by your initial margin (deposit).
- Because most traders do not want to make or take delivery of the currency, most forex broker-dealers automatically roll over the current [value date](#) to the next [value date](#) at each settlement time.
- Rollovers can contribute to your overall performance in a positive way.
- The cost of carry, another term for the rollover differential, is dependent on the [leverage](#) used. This is because you are paid and charged accordingly to the position size, even if you don't have this amount in your [margin account](#).



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- [The spot market by Andy Shearman](#)
- [Introduction to forex by Mark McRae](#)
- [Forex mysteries revealed, by S. Wade Hansen](#)
- [Entering And Exiting Your Trades, by S. Wade Hansen](#)
- [Effectively Using Stop Losses, by S. Wade Hansen](#)
- [How To Get Started Trading Forex, by Steve Primo](#)

External Links:

- [Rollovers, Interest Rate Differentials, And Value Dates](#)
- [Price Mechanism, by Wikipedia.org](#)
- [Modern Money Mechanics – Wikisource](#)
- [BIS Quarterly Review - December 2007- International Banking And Financial Market Development](#)