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Forex Market – Trade or not?

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Abstract:*The paper provides evidence about Foreign Exchange Market, its meaning, functional specifications, pros and cons; tryes to brake myths about Forex superiority or spuriousness.Forex has become last years buzzword. Especially in Georgia, already several firms offer their service for connecting and trading on world market.The currency market is the most massively traded financial market in the world, with a daily average turnover in excess of 5 trillion USD, where abounding market participants are trading over 24 hours.The foreign exchange market is generally compounded of governments, corporations, various types of financial and institutional investors, banks, as well as currency speculators. Roughly 90% of this volume is generated by currency speculators capitalizing on intraday price movements.In spite of there are many forex traders, only a few are really successful ones. Most players fail for the same reasons that investors blunder in other asset classes.There are mainly three views or myths about The Forex. First argue that this is the market of huge opportunities to become rich. Second states that forex is the secondary , supplement way of income. Third belives that this is pure gambling where only market makers gain. We can say that all of these views are true more or less. The outcome of win or lose is directly related with investors profficiency level.Althrough considering the macroeconomic, fundamental and technical analysis necessary for trading on forex market is as crucial as the requisite trading psychology, one of the largest factors thatseparates success from failure is a trader's competence and intelligence to manage a trading account.*

Keywords*: Foreign Exchange Market, Investor Psycology, Market Analysis.*
JEL*: F31, D8, G14*

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I. Introduction

Most countries of the world have their own currencies: The United States has its dollar; the European Monetary Union its euro; Japan its yen; Georgia its lari. Trade between countries involves the mutual exchange of different currencies (or more usually, bank deposits denominated indifferent currencies). When a German firm buys foreign goods, services or financial assets, Euros (typically, bank deposits denominated in Euros) must be exchanged for foreign currency (bank deposits denominated in foreign currency).

Trading of currencies and bank deposits denominated in particular currencies takes place in the foreign exchange market. Transactions conducted in the foreign exchange market induce the exchange rates at which the currencies are changed and traded, which in turn formulate the price worth (cost) of purchasing foreign goods and financial assets.

Foreign exchange market: A system of private banks, foreign exchange brokers and dealers, and central banks through which households, businesses, and governments purchase and sell currencies of various nations.

An exchange rate is the price paid for one currency in exchange for another. It is this type of exchange that drives the forex market.

There are two kinds of exchange rate transaction. The **spot** transactions, that requires the instant (two-day) exchange of bank deposit. The **forward** transaction requires the exchange of bank deposits at particular stated future date. The spot exchange rate is the exchange rate for the spot transaction, and the forward exchange rate is the exchange rate for forward transactions (Mishkin, 2010).

There are many players in the forex market:

Banks - The greatest volume of currency is traded in the interbank market. This is where banks of all sizes trade currency with each other and through electronic networks. A considerable percentage of total currency volume trades come on the big banking institutions. Banks expedite and facilitate currency transactions for clients and conduct speculative trades from their own trading desks. When banks perform a dealer function for consumers, the bid-ask spread is counted the bank's profit. Speculative currency trades are targeted to make a profit on currency fluctuations.

Central Banks - Central banks are extremely important players in the forex market. Open market operations and interest rate policies of central banks influence currency rates to a very large extent. Central banks are responsible for fixing forex market and maintain desired exchange rate regime by which a currency will trade in the open market. The types of exchange rate regimes are: floating, fixed and pegged.
Generally the actions conducted by the central bank in the forex market is aimed to stabilize or maintain the competitiveness of that nation's economy. Central banks can engage in currency interventions to make their currencies appreciate or depreciate

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Investment Managers and Hedge Funds - Professional portfolio managers and hedge funds represent the second-biggest players after banks in the forex market. Investment managers trade various currencies for big accounts such as pension funds and mutual funds. Also they purchase and sell currencies to trade foreign securities in managing of international portfolios. Investment managers may also make speculative forex trades.Hedge funds are making mostly speculative currency trades as well.

Corporations –Companies and firms committed with importing and exporting conduct forex transactions to pay for goods and services. Consider the example of a French airplane producer that imports American components and sells the final goods in China. After the final sale is made, the Chinese yuan must be converted back to euros. The French firm must exchange euros for dollars to purchase the American components.Companies trade on forex to hedge the risk associated with foreign currency translations. So French firm might purchase American dollars in the spot market, or enter into a currency swap agreement to obtain dollars in advance of purchasing components from the American company with the goal to mitigate foreign currency exchange risk.

Individual Investors - The volume of trades conducted by individual investors is very low compared to the big banks and other financial institutions. But this sector is growing rapidly in popularity. Retail investors base currency trades on a combination of fundamentals (interest rate parity, inflation rates, monetary policy expectations, etc.) and technical factors (support, resistance, technical indicators, price patterns) (Rime, 2013).
Forex market participants trade currencies for various reasons. Speculative trades - executed by banks, financial institutions, hedge funds and individual investors - are mainly profit motivated. Central banks participate in forex markets for fulfillment of monetary policy, exchange regime setting, and currency intervention. Corporations trade currency for global business operations and to hedge risk.
The resulting association and collaboration of foreign exchange traders is a highly liquid.It has become a global market that impacts business around the world. Exchange rate fluctuations are considerable factor in inflation, comprehensive corporate earnings and the balance of payments account for each country. For instance, the cargo tradehighlights how market participants and players influence exchange rates that, in turn, have spillover effects on the global economy.
The aim of a trade, fulfilled by banks, other financial institutions, hedge funds, investment managers and individual investors, is devised to capture differences in yields across currencies. It is the chain of borrowing low-yielding currencies and using them to purchase high-yielding currencies. For example, if the British pound has a low yield, market participants would sell it and purchase a higher yield currency. When interest rates changes and begins to fall in GB related to other countries, the investors sell their higher yielding investments. This may result in a broad decrease in global equity prices (Ronner, 2011).

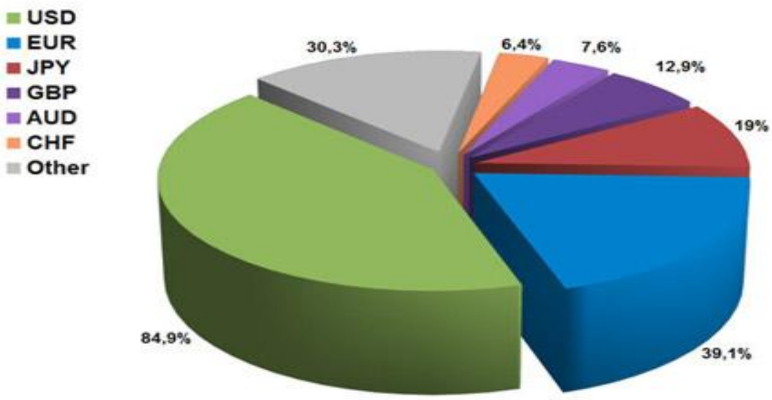
II. Overview Of The Foreign Exchange Market

The foreign exchange market is the largest and most liquid financial market in the world. The currency exchange market is several times bigger than the stock market. According to the Bank for International Settlementssurvey 2013, foreign-exchange trading increased to an average of $5.3 trillion a day and to indicate more precisely this averages out to be $220 billion per hour. The foreign exchange market is generally compounded of governments, corporations, various types of financial and institutional investors, banks, as well as currency speculators. Roughly 90% of this volume is generated by currency speculators capitalizing on intraday price movements.

Contrary the stock and futures market that are located in central physical exchanges, the Foreign exchange market is an over the counter market, decentralized and completely electronically. Banks from Hong Kong to Zurich and from London to New York are trading on forex market during 24 hours. Nevertheless most investors are familiar with the stock market, they can't imagine how small in volume it is in relation to the Forex market.

According to the diagram above, is highlighted forex market's $5.3 trillion per day trading volume outwards the equities and futures markets together. The New York stock exchange needs thirty days of trading to equal one day of forex trading!

Traders from other markets are attracted to the forex because of this extremely high levels of liquidity. Liquidity is crucial as it empowers traders to change positionsat with ease 24 hours a day 5 days a week. It allows large trading volumes to enter and exit the market without the large fluctuations in price that would happen in less liquid market. This means that any time on the market you can find desired buyer or seller. Such liquidity flows from one trading session to another and one currency pair to another.



As the most traded currency, the US dollar makes up 85% of forex trading volume. At nearly 40% of trading volume, the euro is ahead of the third place Japanese yen that takes almost 20%. As the trading volume is mainly concentrated in the US Dollar, Euro and Yen, traders can target their attention just on the major pairs. The permanent greater liquidity found in the forex market is very helpful and facilitates the technical analysis and charting methods.

TOP TRADERS

Rank	Name	Market share
1	Deutsche Bank	14.57%
2	Citi	12.26%
3	Barclays Investment Bank	10.95%
4	UBS AG	10.48%
5	HSBC	6.72%
6	JPMorgan	6.6%
7	Royal Bank of Scotland	5.86%
8	Credit Suisse	4.68%
9	Morgan Stanley	3.52%
10	Goldman Sachs	3.12%

Finally, the size, super liquidity and volume of the forex market make it the excellent trading market. The liquidity facilitates and enables traders to sell and buy currencies immediately. This is why traders from all different asset classes are turning to the Forex market (Blank, 2013).

Like any other market, also the forex market is quided by supply and demand forces: If buyers exceed sellers (high demand), prices go up and if sellers outnumber buyers (high supply), prices go down.

The following factors can influence exchange rates: National economic performance, central bank policy, interest rates, trade balances (imports and exports), political factors (elections and policy changes), market passion (expectations and rumours), unforeseen events (terrorism and natural disasters). Despite all these factors, the global forex market is more stable than stock markets; exchange rates change slowly and by small amounts.

III. Advantages And HazardsOf Forex Trading

Currency trading has become increasingly accessible to (and popular with) individual traders with the widespread availability of online trading platforms.

The following factors make the Forex market look particularly attractive for financial speculators:

3.1 Market volume and Liquidity

The currency market is the most heavily traded financial market in the world, with a daily average turnover in excess of US$5 trillion. With so many market participants trading over 24 hours, the currency markets are more liquid than any other financial market. The volume of foreign exchange-related transactions is significantly higher than that of other markets, which –excluding other factors – eliminates the possibility that some market participants may forge any meaningful alliance to disrupt the market and also enhances the accuracy of technical analysis applied to currency exchange rates.

3.2 Market stability

The impressive trading volumes of the Forex market and the traders' concentration on practical, rational business-oriented goals mitigate risks associated with violent price movements. Nonetheless, the market is by no means inert and responds immediately to global political and economic events.

3.3 Round-the-clock trading

Forex market is an over-the-counter (OTC) market, which means that trades take place electronically not through a centralized exchange. Forex trading takes place around the world, whenever the markets are open. Trades can be executed almost round-the-clock, except on weekends and holidays, with market activity not abating at any time of the day thanks to differences in time zones in Australian, Asian, European, and North American economic areas. Compared to any other financial markets, on forex market players can react to the currency movements caused by economic, political and social events as they occur without having to wait for markets to open. The currency markets offer price volatility 24 hours a day so whatever your trading strategy, you could find numerous trading opportunities. Also this means that the markets are constantly moving and incentives quickly changing, consequently more efforts are needed on monitoring your positions and using the appropriate risk management tools.

3.4 Electronic trading

Any market participant who signs an agreement with a Forex broker can trade either at a dealing center, or at home, via phone or any Internet-connected computer. Actually, anyone can trade on the Forex market whenever and wherever likes.

3.5 Margin trading

This means that a market participant can trade lots, whose cumulative value can substantially exceed (sometimes by hundreds of times) his or her own capital. The most important feature of this trading technique is that long positions (when investor believes that the value will go up) and short positions (when investor believes that the value will go down) yield aproximatelly the same results.

Forex is traded using margin, starting from 0.20% with CMC Markets, which could be referred to as 500:1 leverage. Margin trading can be the effective use of your initial capital due to you only have to provide a percentage of the overall value of your position, while acquiring full exposure to the market. In effect, you are increasing your profit and loss potential. For example, with $100 as position margin, you could enter a position that has an overall value of $50,000. Also that increased leverage enhances losses as well as profits. Additionally, markets can move against you and losses can exceed your initial deposit due to rapid price movements (Rubin, 2015).

3.6 Forex Market Trading Hazards

The foreign exchange market is the bigest and operative market in the world, but in spite of there are many forex traders, only a few are really successful ones. Most players fail for the same reasons that investors blunder in other asset classes. The huge amount of leverage(use of the borrowed capital) to increase the potential return on investments, which is provided by the market, and the relatively low level of margin requirements when trading currencies, deny traders the opportunity to make numerous low-risk mistakes. Based on specific factors related to the trading currencies can cause some players to expect higher and not realistic returns than the market can actually offer, or to bear more risk than they would when trading in other markets.

Those are the most common mistakes can keep traders from achieving their investment goals:

Not Maintaining Trading Discipline - The most common mistake any trader can make is letting emotions control trading decisions. Becoming a successful forex trader is related with catching a few big wins while incurring many smaller losses. Experiencing many losses is difficult to handle emotionally and requires a trader's patience and confidence. Handling and controlling the emotion is reached by trading within a well-constructed trading plan that assists in maintaining trading discipline.

Trading Without a Plan- The first step in achieving success in trading on forex market is to set up and follow a trading plan. The successful trader trades with a documented plan that includes risk management and money management rules and the anticipated expected return on investment. Having and following to a strategic trading plan enables investors evade some of the most common trading pitfalls; trading on forex market without having a plan is the same as playing roulette against casino.

Failing to Adapt to the Market–Of course it is vitally important having a plan for every trade. Conducting scenario analysis and planning the moves and countermoves for every potential market situation can seriously reduce the risk of large, unexpected losses. But like on a battlefield, also on the market situation frequently changes, it presents new opportunities and risks. The most successful players adapt to market changes and modify their strategies to conform to them. Successful traders plan for low probability events and are rarely surprised if they occur. Continuousself-education and adaptation process the changes, enables traders to stay ahead of the pack and find new and creative ways to profit from the evolving market.

Having Unrealistic Expectations- No important what other traders or anyone says, trading on forex market is not a getting rich in an immediate way. It is very important to become proficient enough and parallelly accumulate gains while following the market stream. Success requires enormous efforts to master the strategies adapted to market changes. The main job of the trader is to follow the market stream and catch fat fish as opportunity is presented; but follow up when it is up-warded and do same when down-warded. Trying to “force” the market to provide abnormal returns usually results in traders risking more capital than warranted by the potential profits. Having unrealistic expectations results in undoubted losses. Unrealistic trade strategies or “I want to be like this” attitudes respond to gamble on unrealistic gains means abandoning risk and money management rules that are designed to prevent market remorse.

Poor Risk and Money Management–Risk evaluation and management part in trading strategies is very crucial. Before acquiring enough competence some protection and risk mitigation tactics such as using stop losses and similar tools is very helpful. At any given time, successful traders should know exactly how much of their investment capital is at risk and matched with projected profit are satisfied or not. As the trading account becomes bigger, risk management becomes more important. Risk diversification of trading strategies and currency pairs, with the relevant position sizing, can shield a trading account from irremediable losses. Superior traders will segment their accounts into separate risk/return tranches, where only a small portion of their account is used for high-risk trades and the balance is traded conservatively. Well designed risk management and asset allocation strategy will ensure that low-probability events and broken trades cannot devastate player's trading account.

Managing Leverage- Leverage provides traders with an opportunity to enhance returns. But leverage and the commensurate financial risk is a double-edged sword that amplifies the downside as much as it adds to potential gains. The forex market allows traders to use huge amount of leverage, in some cases even 500:1, which can be the base of big trading gains in some cases, but also wasting losses in others.
Generally, many professional traders operate using 2:1 leverage, which includes trading one standard lot ($100,000) for every $50,000 in their trading accounts. Also one mini lot ($10,000) for every $5,000 and one micro lot ($1,000) for every $500 of account value. The amount of leverage is related to the amount of margin that brokers require for each trade. Margin is like a deposit that investor makes to compensate the broker from potential losses on a trade. The bank unites and pools all those margin deposits into one very large margin deposit that it uses to make trades with the interbank market. If on the trade something goes wrong, then the broker sends to the investor the margin call, where brokers demand additional cash deposits; if such additional money is not provided, broker will sell the position at a loss to mitigate further losses or recoup their capital (so banks never have losses).
The core reason due to most forex traders fail is that they are undercapitalized(not having enough capital) in relation to the size(using large leverage) of the trades they make. Those all are emotions, either greed or the prospect of controlling huge amounts of money with only a small amount of capital that captures forex traders to take on huge and reckless financial risk. For example, at a 100:1 leverage (mainly common leverage ratio), it only takes a -1% change in price to result in a 100% loss, when your capital totally evaporates (Stammers, 2014).
While the forex market is less volatile in the long term than the equity market, it is difficult to resist periodic losses and the negative effect of those losses especially with high leverage levels, a disaster is to happen. Also the forex market is driven and contains a significant level of macroeconomic and political risks that can be the base of short-term pricing volatilities and could play havoc with the value of certain currency pairs.

IV. Conclusion

Forex Market – a huge virtual economic area in which the world's most popular currency pairs are presented: euro-dollar, dollar-yen, pound-dollar, and others. This global electronic currency exchange is not considered by the exchange, but it is the largest financial market. It is up to the events that occur in it, depends on the euro today, the dollar tomorrow – and indeed all the major courses of national currencies.

On the Forex market the big players (central and commercial banks, investment and insurance companies, etc.) make the exchange of one currency for another, and this is used for this amount of money, which instantly creates a significant movement in the market: the price of one currency starts to increase relative to the other. This leads to the fact that a pair of quotation changes.

In its terminals such processes can watch individual traders – those who want to capitalize on increasing or decreasing prices. They look at the chart of the currency pair, analyze and, as a result, offer a deal to buy or sell. At this point, they become speculators Forex market. If their prediction was correct and the price of the pair (the quote) went where they thought through some time traders can close the deal and see your trading account profits. From account you can immediately withdraw, and you can continue to trade and make money.

Of course, trading is a very risky business. Each broker warned its clients that the financial market can lose the invested funds. After all, not everyone can be calculated and analyzed: there are those of force majeure, as an intervention, the gap, the sudden news that may adversely affect the already open transaction.

But that never stopped traders. Anyway, with the risk linked to virtually all the events of our lives, and Forex – this is a great opportunity to earn a decent amount of money wherever there is access to the Internet at home, at the office, in the village, or even the sea. Trades available around the clock from Monday to Friday.

Another indisputable advantage of this type of activity that you will always be aware of economic and political news. This will help you, in time, learn to understand how the market might react to an event, and benefit from the most direct benefit.

Trading in the Forex market, it is important to understand that the loss of certain amounts as a result of an incorrect forecast – this is the reality, which is essential for the normal operation of any financial market, whether it is a commodity market, stock market and currency market. At the same time, it increases the joy of successful transactions, teaches discipline and gives invaluable experience and increases the effectiveness of your trading strategies.

The factors that cause forex traders to fail are mostly similar to those that devastates investors in other types of assets. One of the right way to avoid some of these pitfalls is to build a relationship and cooperate with other successful forex traders who can teach you the trading disciplines required by the certain asset class, including the risk and money management rules required to trade the forex market. This is one of the wise way that makes you able to plan appropriately and trade with the return expectations that keep you from taking excessive risk for the potential benefits.

Althrough considering the macroeconomic, fundamental and technical analysis necessary for trading on forex market is as crucial as the requisite trading psychology, one of the largest factors that separates success from failure is a trader's competence and intelligence to manage a trading account. The keys to account management include making sure to be sufficiently capitalized, using appropriate trade sizing and limiting financial risk by using smart leverage levels.

“There is no sphere of human influence in which it is easier to show superficial cleverness and the appearance of superior wisdom as in matters of currency and exchange”
Winston Churchill.
House of Commons 1946

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