FX COURSE FOR BEGINNERS

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SECTION : ONE

THE FX MARKET

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Part I. What is the FX Market?

The "Foreign Exchange" market, also referred to as the "Forex" or "FX market", is the largest market in the world with over $1.9 trillion changing hands daily and soon expected to top $2 trillion. Compare that to the New York Stock Exchange at $57.6 billion, the equities market at $191 billion, and the daily value of the futures market at $437.4 billion, and you will clearly see that the FX market alone is approximately three times the total amount of the US Equity and Treasury markets combined.

Unlike other financial markets, the Forex market has no physical location and no central exchange. It operates through an electronic network of banks, corporations, institutional investors, and individuals trading one currency for another. The lack of a physical exchange enables the Forex market to operate on a 24-hour basis, spanning from one time zone to another, across the major financial centers around the world.

The FX market plays a key role in transferring financial payments across borders and moving funds and purchasing power from one currency to another. This international market plays an extensive and direct role in national economies and has a major impact that affects our lives and our prosperity. The movement of different currencies between countries determines a very important price – the exchange rate. It is the exchange rate that allows the currencies to be traded for profit.

There are two major reasons to buy and sell currencies:
1) About 5% of daily turnover is from companies and governments that buy or sell products and services in foreign countries, then profits made are converted back into their domestic currency.
2) The other 95% is trading for profit or speculation, which translates to the tremendous profit- potential in this highly lucrative market.

Trading for speculation in the FX market has increased tremendously throughout the years as institutions and individuals recognize the high profit potential in this highly lucrative market. Although speculative trading is increasing, not everyone involved in Forex is a speculator. Therefore, there is a far less risk of manipulation within the FX market. Even in the case of central bank intervention, the overall effect on the FX market is relatively insignificant. Forex is a genuine market in which the prices of currencies are solely determined by the forces of supply and demand. As a result, all market participants, including individual traders, are well-protected from artificial manipulation of prices. Unfortunately, this protection for traders does not extend to other markets. In the equity market, everyone is a speculator, including individuals and corporations. When everyone is speculating for profit, manipulation of prices is inevitable. Consequently, traders in the equity market suffer immensely when prices are manipulated by various institutions.

Until recently, large international banks dominated the FX market, only allowing access via telephone trading to major corporations, large funds, and high net worth individuals. This little known, underexposed, foreign exchange currency market can now be traded online and is available to the general public with a minimal capital investment of $300. Individual investors now have the opportunity to trade in the largest and most liquid financial market in the world.

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Part II. Why Trade FX?

Foreign exchange is by far the preferred market choice for aggressive traders. The FX market offers unparalleled liquidity, no slippage, market transparency, trending markets, 24-hour access, low to zero transaction cost, high leverage, low account minimums, no bear-only market, and most importantly, above average profit potential.

Enormous Liquidity

The FX market is the most liquid market in the world. It can absorb trading volumes and per-trade sizes that may overwhelm any other market. Trading essentially consists of two parts: opening a position and closing of that position. Liquidity, which is highly correlated with volume, qualitatively evaluates how easily traders can enter and exit positions. A liquid market enables participants to execute large volume transactions with little impact on market prices. On the simplest level, the enormous liquidity alone is powerful enough to attract any investor to the FX market, as it suggests the freedom to open or close a position at will. In addition, technical analysis, the study of price movements, operates better in liquid markets. Illiquid markets make it much more difficult to accurately determine entry and exit points.

Minimal Slippage

Traders in illiquid markets may experience delays and subsequently, suffer from slippage. In these markets, there may be delays in the execution of traders' orders and thus, market orders could potentially be filled at a different price from the market rate when the order was initially placed. Furthermore, traders may experience difficulty in exiting or selling positions, which greatly compromises the ability to clear profitable trades. In the FX market, there is minimal slippage usually during economic announcements – traders will normally get in and out at the price they placed their orders. This is due to the tremendous amount of volume that the FX market generates.

Market Transparency

Market transparency is highly desired in a trading environment. It is a condition in which market participants are able to observe the detailed information in the trading process. Ultimately, the greater the market transparency, the more efficient the market becomes. The FX market offers the highest level of market transparency out of all financial markets.

Informed traders are better off than uninformed traders because most financial markets could be exploited by those with private information. Traders in all financial markets rely on market transparency because it allows them to see a transparent spread, which enables them to employ their premeditated strategies while still flexible enough to accommodate an ever-changing marketplace. With the transparency of information, traders can exercise their risk management strategies in accordance to their fundamental and technical approaches.

For example, in the case of Enron, inaccurate reporting by officers of the company resulted in the downfall of the company and losses of many shareholders. Markets where this could occur are considered a poor trading market. Furthermore, market transparency ensures the ability to trade from live, executable prices. Markets that do not offer executable prices and force traders to absorb slippage, obviously compromise traders' profit potential.

Trending Markets

Although currency prices in the FX market may be volatile, they generally repeat themselves in cycles, creating trends. The trends can be analyzed by traders using technical tools. Since technical analysis statistically works better in markets characterized by cycles and trends, traders benefit from this attribute of Forex. The entire premise of technical analysis is based on the study of price movements. Through this analysis, traders can identify trends and capture key entry and exit points at which they should execute their trades and maximize their profit potential.

24-hour Access

Forex is a true 24-hour, 6 days a week, market. FX trading begins each day in Australia and moves around the globe as the business day begins in each financial

center – first to Tokyo, then London, and New York. Unlike any other financial market, investors can respond to currency fluctuations caused by economic, social, and political events at the time they occur regardless if it is daytime or nighttime. The only breaks in trading occur during a brief period over the weekend. A trader is able to put on a trade during the London session, follow it during the New York session, and close the trade in the middle of the following day during the Tokyo session. This type of market access is invaluable to a market participant who needs to react quickly to global events.

Low to Zero Transaction Cost

The amount of cost to execute trades has dropped considerably in recent years. Transaction costs include all the expenses to actually execute a trade. Because transaction costs reduce profits, the lower the transaction costs, the more beneficial it is for the trader. Markets that have centralized exchanges tend to have higher transaction costs due to exchange and clearing fees associated with trading. Active stock and futures traders often see substantial portions of their gross profits going to broker commissions, exchange fees, and data/chart feeds. Transaction costs can also be increased with faulty executions. In regards to the FX market, there is little to no brokerage fees and zero exchange and clearing fees since it is an over-the-counter market. What you see is what you get, allowing you to make quick decisions on your trades without having to account for fees that may affect your profit/loss or slippage.

High Leverage

The FX market provides traders with access to much higher leverage than other financial markets. FX traders can benefit from leverage in excess of 100 times their capital versus the 10 times capital that is typically offered to professional equity day traders. In the FX market, the margin deposit for leverage is not a down payment on a purchase of equity; instead, it is a performance bond, or good faith deposit, to ensure against trading losses. This is very useful to short-term day traders who need the enhancement in capital to generate quick returns.

Low Account Minimums

Many individuals believe that entering the highly lucrative foreign exchange market requires large initial trading capital. This was indeed true prior to 1996, without the integration of online trading into the FX market. Today, individuals can get started with a mini-account for as little as $300.

No Bear-Only Market

One of the biggest advantages of trading FX is that there is no fear of a bear-only market. In many markets, high-return investments can often be difficult to sell after they are bought. However, in Forex, the major currency pairs always have buyers and sellers; hence, the FX investor should never worry about being "stuck" in a trade due to lack of market interest.

Above Average Profit Potential

There is no question that speculative trading in Forex offers huge profit potential. It is an exciting way to earn exceptionally high returns on one's investment capital.

Part III. Brief History of the FX Market

Timeline of the Foreign Exchange

Year	Event
1944	Bretton Woods Accord established to help stabilize the global economy after WWII.
1971	Smithsonian Agreement established to allow greater fluctuation band for currencies.
1972	European Joint Float established as the European community tried to move away from their dependency on the US dollar.
1973	Smithsonian Agreement and European Joint Float failed, signifying the official switch to free-floating system.
1978	European Monetary System was again introduced in attempt to gain independence from the US dollar.
1978	Free-floating system officially mandated by the IMF.
1993	European Monetary System failed, making way for a world-wide free-floating system.
2003	FX Trainer began offering products to help people tap into the potential high income opportunity found in the FX market.

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The Foreign Exchange market, ("FX" or "Forex") as we know it today, originated in 1973. However, money has been around in one form or another since the time of the Egyptian Pharaohs. While the Babylonians are credited with the first use of paper bills and receipts, Middle Eastern moneychangers were the first currency traders exchanging coins of one culture for another. During the middle ages, paper bills emerged as an alternative form of currency besides coins. These paper bills represented transferable third party payments of funds, which made foreign exchange much easier and less cumbersome for merchants and traders.

From the infantile stages of Forex during the Middle Ages to World War I (WWI), the Forex market was relatively stable and without much speculative activity. After WWI, it became very volatile and speculative activity increased ten fold. Speculation in the Forex market was not looked on as favorable by most institutions and the public in general. The Great Depression and the removal of the gold standard in 1931 created a serious lull in Forex activity. From 1931 until 1973, the Forex market went through a series of changes. These changes greatly impacted the global economies at the time. Speculation in the Forex market during these times was little if any.

Gold Exchange Standard

The "Gold Exchange Standard", which prevailed between 1876 and WWI, dominated the international economic system. Under the gold exchange standard, currencies gained a new phase of stability as they were supported by the price of gold. It abolished the age-old practice in which kings and rulers arbitrarily debased money and triggered inflation.

However, the gold exchange standard had its weakness. As an economy strengthened, it would import heavily from abroad until it ran down its gold reserves required to back its money. As a result, money supply would shrink, interest rates would rise, and economic activity would slow down to the extent of recession. Ultimately, prices of goods would bottom out, appearing attractive to other nations. Consequently, this would cause a rush in buying sprees that would inject the economy with enough gold to increase its money supply, drive down interest rates, and recreate wealth into the economy. Such patterns prevailed throughout the gold standard until the outbreak of WWI, which interrupted trade flows and the free movement of gold.

Several other major transformations occurred after the Gold Exchange Standard, leading to the birth of the current FX market: the Bretton Woods Accord, Smithsonian Agreement, and the Free-Floating System.

Bretton Woods Accord

The first major transformation, the Bretton Woods Accord, occurred toward the end of World War II. A total of 44 countries, including the United States, Great Britain, and France met in New Hampshire in July 1944, to design a new economic order.

Bretton Woods
New Hampshire in July 1944

The design of the Bretton Woods framework was to have the United States become an anchor for all free world currencies. The accord aimed at installing international monetary stability by preventing money from fleeing across nations and restricting speculation in the world currencies. Major currencies were pegged to the dollar, which was in turn tied to gold at a value of $35 per ounce. The dollar was the primary reserve currency and member countries were able to sell currency to the Federal Reserve in exchange for gold at the present rate. In addition to these interventions, the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World

Bank) were established to ensure that the Bretton Woods system would operate effectively.
Once the Bretton Woods Agreement was founded, the participating countries agreed to try and maintain the value of their currency with a narrow margin against the dollar and a corresponding rate of gold as needed. Countries were prohibited from devaluing their currencies to their trade advantage and were only allowed to do so for devaluations of less than 10%.

Trading under the Bretton Woods system had unique characteristics. Since exchange rates were fixed, intense trading took place around devaluation or revaluation, known as creeping pegs. Speculation against the British pound in 1967 demonstrated creeping pegs patterns. Despite all the efforts by the Bank of England and other central banks to support the pound, the pound was devalued. This failure was monumental because it was the first time that the central bank intervention failed under the Bretton Woods system. The failure of the central bank intervention continued with the dollar in the following years. As the Bretton Woods system was highly dependant on a strong US dollar, the dollar began to experience pressure in 1968, causing extreme speculation on the future of this system. The Agreement was finally abandoned in 1971, and the US dollar would no longer be convertible into gold.

Smithsonian Agreement

After the Bretton Woods Accord came to an end, the Smithsonian Agreement was signed in December of 1971. This agreement was similar to the Bretton Woods Accord, but it allowed for a greater fluctuation band for foreign currencies.

The Smithsonian Agreement strived to maintain fixed exchange rates, but to do so without the backing of gold. Its key difference from the Bretton Woods system was that the value of the dollar could float in a range of 2.25%, as opposed to just 1% under Bretton Woods.

Ultimately, the Smithsonian Agreement proved to be unfeasible as well. Without exchange rates fixed to gold, the free market gold price shot up to $215 per ounce. Moreover, the U.S. trade deficit continued to grow, and from a fundamental standpoint, the US dollar needed to be devalued beyond the 2.25% parameters established by the Smithsonian Agreement. In light of these problems, the foreign exchange market was forced to close in February of 1972.

In 1972, the European community tried to move away from their dependency on the dollar. The European Joint Float was established by West Germany, France, Italy, the Netherlands, Belgium, and Luxemburg. Both agreements made mistakes similar to the Bretton Woods Accord and by 1973, collapsed.

Free-Floating System

The collapse of the Smithsonian agreement and the European Joint Float in 1973 signified the official switch to the free-floating system. This occurred by default as there were no new agreements to take their place. Governments were now free to peg their currencies, semi-peg, or allow them to freely float. In 1978, the free-floating system was officially mandated.

The value of the US dollar was to be determined entirely by the market, as its value was not fixed to any commodity, nor was the fluctuation of its exchange rate confined to certain parameters. While this did provide the US dollar, and other currencies by default, the agility required to adapt to a new and rapidly evolving international trading environment, it also set the stage for unprecedented inflation.

Europe tried to gain independence from the dollar by creating the European Monetary System in July of 1978. This, like all of the earlier agreements, failed in 1993.

The major currencies today move independently of other currencies. The currencies are traded by anyone who wishes to trade. This has caused a recent influx of speculation by banks, hedge funds, brokerage houses, and individuals. Central banks intervene on occasion to move or attempt to move currencies to their desired levels. The underlying factor that drives today's Forex

market, however, is supply and demand. The free-floating system is ideal for today's markets.

Part IV. Market Structure

Overview

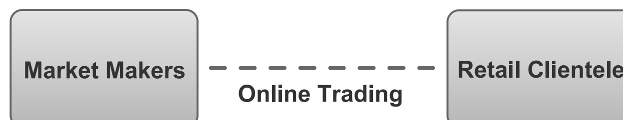
Unlike other financial markets, the Forex market has no physical location and no central exchange; hence, it is considered an over-the-counter (OTC) market. The FX market operates through an electronic network of banks, corporations, institutional investors, and individuals trading one currency for another. Forex traders and market makers are all linked to one another round the clock via computers, telephones, and faxes where currency denominations, amounts, settlement dates, and prices are negotiable. The lack of a physical exchange enables the Forex market to operate on a 24-hour basis, spanning from one time zone to another, across the major financial centers around the world.

The FX market is organized into a hierarchy, which consists of participants with different ranking. The standards that determine the participants' positions are credit access, volume of transactions, and level of sophistication; those with superiority in these measures receive priority in the FX market. At the top of the hierarchy is the interbank market, which generates the highest volume in trades.

Interbank

Interbank is a credit-approved system where banks trade on the sole basis of their credit relationships with one another. In the interbank market, the largest banks are able to trade with each other directly, via interbank brokers or through electronic brokering systems such as Reuters and EBS. While all the banks can see the rate that everyone is dealing at, each bank has a specific credit relationship with the other bank and trade at the rates being offered.

Other institutions in the market, such as corporations, online FX market makers, and hedge funds trade FX through commercial banks. However, many banks (community banks and banks in emerging markets), corporations, and institutional investors do not have access to these rates because they do not have established credit relationships with large commercial banks. Subsequently, these smaller participants are obligated to trade FX through a large bank, and often, this equates to much less competitive rates. The rates become less and less competitive as it trickles down the hierarchy of participants. Eventually, the customers of banks and foreign exchange agencies receive the least competitive rates. However, in the late 1990's, technological advances have eliminated the barriers that existed between the interbank and end-users of FX. Since 1996, retail clientele can connect directly to market makers via online trading. Average traders can enjoy the competitive rates and trade alongside the world's largest banks.



The FX market is no longer reserved for big corporations; it is now made available to all types of consumers. Furthermore, the boundless opportunity to trade foreign exchange awaits all aspiring corporations and individual traders.

Market Hours

The spot FX market is unique to any other market in the world since trading is available 24 hours a day. Somewhere around the world, a financial center is open for business, and banks and other institutions exchange currencies every minute of the day with only minor gaps on the weekend. The FX market opens at 5 pm (EST) on Sunday and close at 1 pm (EST) on Friday.

The major financial centers around the world overlap due to their time zones. The International Date Line is located in the Western Pacific. Each business day begins in Wellington, New Zealand, then Sydney, Australia, followed by the Asian financial markets starting with Tokyo, Japan, Hong Kong, China, and

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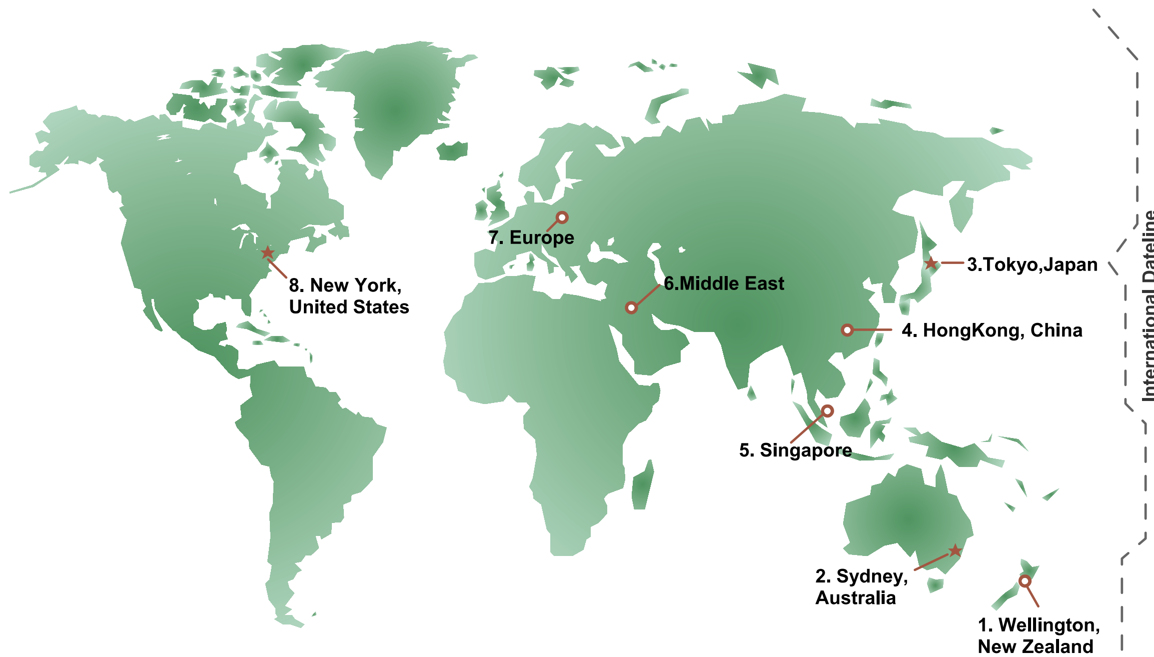
finally Singapore. Only a few hours later, markets will open in the Middle East. When the markets in Tokyo are starting to wind down, Europe opens for business. Finally, New York and other major U.S. centers start their day. Towards the late afternoon in the United States, the next day arrives in the Western Pacific areas and the process begins again. Hence, the FX market is opened 6 days a week, 24 hours a day.

Financial Centers World-wide



Markets within the FX Market

Although spot trading accounts for 48% of all FX transactions worldwide, the three main markets, Tokyo, London, and New York, represent almost 70% of the world's FX volume. Foreign exchange activity does not flow evenly, and throughout the course of the international trading day, there are certain markets characterized by very heavy trading activity in some (or all) currency pairs. At other times, the same markets are characterized by light activity in some (or all) currency pairs. Foreign exchange activity tends to be the most active when markets overlap, particularly the U.S. markets and the major European markets; i.e., when it is morning in New York and afternoon in London.

Time Zone	United States	London	Tokyo
Tokyo Open	7:00 pm	0:00	9:00
Tokyo Close	4:00 am	9:00	18:00
London Open	3:00 am	8:00	17:00
London Close	12:00 pm	5:00	14:00
NY Open	8:00 am	13:00	22:00
NY Close	5:00 pm	22:00	7:00

Tokyo: 7:00pm – 3:00am EST

7:00 pm To 3:00 am

$150 Billion

As Japan's economy has dwindled over the past decade, Japanese banks have been unable to commit to FX, the large amounts of capital they once did in the 1980's. Despite this, Tokyo is the first major market to open, and many large participants use it to get a read on dynamics or to begin scaling into positions.

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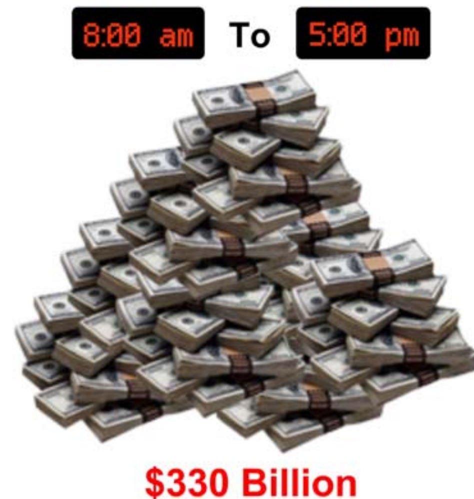
Approximately 10% of all FX trading volume takes place during the Tokyo session. Trading can be relatively thin. Hedge funds and banks have been known to use the Tokyo lunch hour to run important stop and option barrier levels. Japanese yen, New Zealand dollar, and Australian dollar pairs tend to be the biggest movers during Tokyo hours as other currencies are quite thin and usually remain constant.

London: 3:00am to 11:00am EST

London is by far the most important and influential FX market, with approximately 30% of all worldwide transactions. Most big bank's dealing desks stem from London and the market is responsible for roughly 28% of the total world spot volume. London tends to be the most orderly market due to the large liquidity and ease of completing transactions. Most large market participants use London hours to complete serious foreign exchange deals.

New York: 8:00am – 5:00pm EST



New York is the second most important market that represents approximately 16% of total worldwide market volume. In the United States spot market, the majority of deals are executed between 8am and 12pm, when European traders are still active. Trading often becomes slower in the afternoon as liquidity dries up. In fact, there is a drop of over 50% in trading activity since California never served to bridge the gap between the U.S. and Asia. As a result, traders tend to pay less attention to market development in the afternoon. New York is greatly affected by the U.S. equity and bond markets, thus the pairs will often move closely in tandem with the capital markets.

Part V. Key Players in the FX Market

With the advances of technology and especially the opening on the Internet, the foreign exchange market has expanded from simple foreign exchange and bank transactions to a more speculative nature. Today, an increasing number of FX transactions are trading for profit or speculation, which translates to the tremendous profit-potential in this highly lucrative market. There are five major players in the FX market; Commercial/Investment Banks, Central Banks, Corporations, Hedge/International Funds, and individuals.

Commercial and Investment Banks

Commercial and investment banks account for the largest portion of FX trading volume. The Interbank market caters to both the majority of commercial turnovers as well as enormous amounts of speculative trading everyday. Their primary role in the FX market is essentially selling currencies, as other participants execute trades through them. Banks trade currencies because it is highly lucrative and it limits their credit exposure on Letters of Credit. Banks gain profits by acting on their clients' behalf and making trades. About three quarters of all foreign exchange trading is between banks. They generate billions of dollars worth of currency in a day's volume.

Top Financial Institutions
1. Citigroup
2. Deutsche Bank
3. Goldman Sachs
4. JP Morgan
5. Chase Manhattan
6. Credit Suisse First Boston
7. UBS Warburg
8. State Street Bank & Trust
9. Bank of America
10. Morgan Stanley

Below is a list of the top financial institutions in the world as rated by Euromoney Magazine in their May, 2001 edition.

Central Banks

Central banks play a significant role in the FX market as they can influence spot price fluctuations. Central banks generally do not speculate in currencies, but they use currencies to promote acceptable trading conditions to their banking industries by affecting money supply and interest rates through open market operations or the active trading of government securities. Central banks also often attempt to restore order to volatile markets through interventions. The reasons for central bank interventions may be a result of a variety of factors: to restore stability, protect a certain price level, slow down currency movements, or to reverse a trend. An example would be the recent intervention by the Bank of Japan to push down the value of the yen. On the surface, this may disturb many traders to make their investment decisions. However, it has been proven time and again that central banks can only influence currency values for short periods. Over time, the markets adjust to the changes, creating trend formations that may be very beneficial to traders. Trend strategies may guide FX traders to take advantage of these trends in the market.

Central banks normally keep sizeable amounts of foreign currencies on hand; hence, their influence is so great that the mere mention of central banks' interventions would violently move the market. As their investments are generally more long-term, central banks' trades are quite profitable. The major central banks include: The Federal Reserve, European Central Bank, Bank of England, Swiss National Bank, Bank of Japan, and Bank of Canada.

The Federal Reserve (Fed):

The Federal Reserve Board (Fed) is the central bank of the United States. They are responsible for setting and implementing monetary policy. The board consists of a 12-member committee, which comprise the Federal Open Market Committee (FOMC). The voting members of the FOMC are the seven Governors of the Federal Reserve Board, plus five Presidents of the twelve district reserve banks. The FOMC holds 8 meetings per year, which are widely watched for interest rate announcements or changes in

growth expectations. The Fed has a high degree of independence to set monetary authority. They are less subject to political influences, as most members are assigned long term positions that allow them to remain in office through periods of alternate party dominance in both the Presidency and Congress. The U.S. Treasury is responsible for issuing government debt and for making fiscal policy decisions. Fiscal policy decisions include determining the appropriate level of taxes and government spending. The U.S. Treasury is the actual government body that determines dollar policy. That is, if they feel that the USD rate in the foreign exchange market is under- or overvalued, they are in the position of giving the NY Federal Reserve Board the instructions to intervene in the FX market by physically selling or buying USD. Therefore, the Treasury's view on dollar policy, and changes to that view, is very important to the currency market.

The European Central Bank (ECB):

The European Central Bank (ECB) is the governing body responsible for determining the monetary policy of the countries participating in the European Member Union (EMU). The Executive Board of the EMU consists of the President and Vice President of the ECB and four other members. These individuals along with the governors of the national central banks comprise the Governing Council. The ECB is set up such that the Executive Board implements the policies dictated by the Governing Council. New monetary policies decisions are typically made by majority vote in biweekly meetings, with the President having the casting vote in the event of a tie. The primary objective of the European Central Bank is to maintain price stability. ECB is considered "inflation paranoid" as it has strong German influence. ECB and the ESCB are independent institutions from both national governments and other EU institutions, giving them total control over monetary and currency policy. The European central bank is a strict monetarist and much more likely to keep interest rates high. Two edicts of monetary policy are: to keep a harmonized Consumer Price Index (CPI) below 2% and an M3 annual growth (Money supply) around 4.5%. Refinance rate is the main weapon used by the ECB to implement EU monetary policy. ECB watches the fiscal discipline of its members closely. ECB is considered an untested central bank and doubts linger as to how they will react to any future crisis. The ECB keeps close tabs on budget deficits of the individual countries as the Stability and Growth Pact states that they must be kept below 3% of Gross Domestic Production (GDP). The ECB does intervene in the FX markets, especially when inflation is a concern. Comments by members of the Governing Council frequently move the EUR and are widely watched by FX market participants.

Bank of England (BoE):

The Bank of England (BoE) is the central bank of the United Kingdom. The bank was founded in 1694, nationalized in 1946, and gained operational independence in 1997. The BoE is committed to promoting and maintaining a stable and efficient monetary and financial framework as its contribution to a healthy economy. In 1997, the parliament passed the Bank of England Act, giving the BoE total independence in setting monetary policy. Prior to 1997, the BoE was essentially a governmental organization with very little freedom. Treasury's role in setting monetary policy diminished markedly since 1997. However, the Treasury still sets inflation targets for the BoE, currently defined as 2.5% annual growth in Retail Prices Index (RPI), excluding mortgages (RPIX). The treasury is also responsible for making key appointments at the Central Bank. The BoE's nine member Monetary Policy Committee (MPC) is responsible for making decisions on interest rates. Although MPC has independence in setting interest rates, the legislation provides that in extreme circumstances the government may intervene. The Bank of England's main policy tool is the minimum lending rate or base rate. Changes to the base rate are usually seen as a clear change in monetary policy. BoE most frequently affects monetary policy through daily market operations (the buying/selling of government bonds). The BoE is infamous for attempting to influence exchange rates through impure market interventions.

Swiss National Bank (SNB):

The Swiss National Bank is the central Bank of Switzerland. The Swiss National Bank enjoys 100% autonomy in determining the nation's monetary and exchange rate policies. In December 1999, the SNB shifted from a monetarist approach to an inflation-targeting one (2% annual inflation target). Discount rate is the official tool used to announce changes in monetary policy; however, it is rarely used as the bank relies more on the 3-month London Interbank Offer Rate (LIBOR) to manipulate monetary policy. LIBOR is the rate at which major international banks lend to one another; it primarily serves as a benchmark for short-term interest rates. SNB officials often affect the Franc spot movements by making remarks on liquidity, money supply, and the currency itself. Intervention is frequent; however, most often intervention is used to enforce economic policy. It is also used in open market operations, such as raising or lowering interest rates, to affect the value of its currency. As a country where international trade has been the primary source of the country's economic development, its preference is for a weaker franc, in order for its exports to remain competitive. SNB is highly regarded and the franc is considered by most market participants to be the world's best managed currency.

The Bank of Japan (BOJ):

The Bank of Japan (BoJ) is the key monetary policymaking body in Japan. In 1998, the Japanese government passed laws giving the BoJ operational independence from the Ministry of Finance (MoF). It was given the complete control over monetary policy. However, despite the government's attempts to decentralize decision-making, the MoF still remains in charge of foreign exchange policy. MoF is considered the single most important political and monetary institution in Japan. MoF officials frequently make statements regarding the economy, which have notable impacts on the yen. The BoJ is responsible for executing all official Japanese FX transactions at the direction of the MoF. However, it is important to note that the Bank of Japan does possess total autonomy over monetary policy and can have significant indirect impacts on foreign exchange rates. The BoJ's main economic tool is the overnight call rate. The call rate is controlled by the open market operations and any changes to it often signify major changes in monetary policy. Since the introduction of a floating exchange rate system in February 1973, the Japanese economy has experienced large fluctuations in Forex rates, with the yen on a long rising trend. The reason for the yen's strength, despite the excessive problems that have plagued the Japanese economy, is the fact that Japan has a trade surplus accounting for 3% of GDP. This is the highest of the G-7 countries and therefore creates a strong inherent demand for the currency for trade purposes, regardless of their economic conditions. The Japanese government is notorious for directly intervening on behalf of the yen through market interventions. BoJ interventions are frequent and violent. As an export-driven country, there are strong political interests in Japan for maintaining a weak yen in order to keep exports competitive. Accordingly, the BoJ has been known to go into the market and sell off the yen when its rate is perceived to be too strong.

Bank of Canada (BoC):

The Bank of Canada (BoC) is the central bank of Canada. The Governing Council of the Bank of Canada is the board that is responsible for setting monetary policy and is an independent Central bank that has a tight reign on its currency. This council consists of seven members: the Governor and six Deputy Governors. The BoC does not have regular periodic policy setting meetings.

Instead, the council meets on a daily basis and may make changes in policy at any time. Due to its tight economic relations with the United States, the Canadian dollar has a strong connection to the US dollar.

Corporations

Corporations which comprise a diverse group of small and large corporations, importers/exporters, financial service firms, and consumer service firms, were the major traders in currencies for many years.

Corporations' main interests in foreign exchange are to perform transactions related to cross border payments. Multinational corporations may need to make payments to foreign entities for materials, labor, marketing/advertising costs, and/or distributions, which would require the exchange of currencies. The primary focus of multinational corporations in the marketplace is to offset risk by hedging against currency depreciation, which would affect future payments. Now, however, a minority have begun to use the marketplace as a speculative tool; meaning, they enter the FX market purely to take advantage of expected currency fluctuation. This group of corporations using the FX market for speculative purposes is growing, and as very active participants, they have a great impact on spot market prices. Corporations' approach to trading tends to be longer-term since they use the market for covering commercial needs, hedging, and speculations.

Hedge Funds and International Funds

Global fund managers, hedge, large mutual, pension, and arbitrage funds that invest in foreign securities and other foreign financial instruments are relatively small. Although they may be small when compared to other market participants, they are the most aggressive. These groups can have substantial impacts on spot price movements as they are constantly re-balancing and adjusting their international equity and fixed income portfolios. These portfolio decisions can be influential because they often involve sizable capital transactions. A majority of the hedge funds are highly leveraged and actively seeking to profit in whichever way possible. Despite the highly criticized, sometimes devious nature of hedge funds, they are valued by traders because they often push the markets to retract from extreme levels. Hedge funds are used by high net worth individuals investing a minimum of $1 million. One of the best known Hedge Funds is the George Soros Quantum Group of Funds that made a billion dollar profit by shorting the British pound in 1992.

International Funds are non-currency funds consisting of large capital, which exert substantial influence on the FX market. With more and more funds delegated to hedging activities, international funds are becoming a main driver of international capital and equities trends, which in turn, greatly affects the Forex market.

FX Funds

Funds that invest in the FX are commonly called Global Macro funds. These funds depending on size tend to take different positions in the FX market. Many large funds tend to carry large trade positions, exploiting global interest rate differentials. Others tend to seek out opportunities to take advantage of misguided economic policies or currencies that overshoot their real value; by entering large positions, they are betting on a return to equilibrium. Others simply gauge global events and take a longer-term view on which currencies will strengthen or weaken in the next six to eight months. Fund participation in the FX market has risen sharply in recent years and its total trading share is now around 20%. There is no doubt that with the increasing amount of money some of these investment vehicles have under management, the size and liquidity of the foreign exchange market is very appealing. While relatively small compared to other market participants, when acting together, they can have a profound effect on the currency spot movements.

Individuals

Retail spot currency trading is the new frontier of the trading world. Up until 1996, foreign exchange trading was only available to large banks, institutions, and extremely high net worth individuals. Prior to online retail FX dealers, individuals could not realistically participate in the FX market from a speculative standpoint. The interbank market operated as a tight circle; it acted somewhat like a specialist, as it manipulated the fates of tiers 2 and 3 to accommodate its own needs. Accordingly, individual traders looking to trade FX could not find a market maker capable of providing competitive spreads, fair quotes, and equitable customer service.

With the advancement of technology, the internet, and online trading platforms, retail clients are provided with access to trading that is highly comparable to the offerings of the interbank market. Spreads are slightly wider at 3-5 pips on most currency pairs, as opposed to

the interbank standard of 1-2 pips, but execution is unsurpassed. Now retail clients and multinational institutions can participate in the FX market on a highly equitable playing field.

Part VI. International Oversight

The **International Monetary Fund** (**IMF**) is a cooperative organization that 182 countries have voluntarily joined. It exerts an international influence over world monetary issues, including the foreign exchange market. However, it has no effective authority, either by law or implied, over the domestic policies of its members.

The IMF Aims To:

- **Promote international cooperation by providing the means for members to consult and collaborate on international monetary issues.**
- **Facilitate growth of international trade and thus contribute to high levels of employment and real income among member nations.**
- **Promote stability of exchange rates and orderly exchange agreements, and discourage competitive currency depreciation.**
- **Foster a multilateral system of international payments and seek the elimination of exchange restrictions that hinder the growth of world trade.**
- **Make financial resources available to members, on a temporary basis and with adequate safeguards, to permit them to correct payment imbalances without resorting to measures destructive to national/international prosperity.**

Part VII. FX Regulations

For many years, the retail online foreign exchange industry languished due to the lack of a regulatory environment to uphold investor protection. In December 2000, however, Congress passed and the President signed the Commodities Modernization Act in December of 2000. The Act finally regulated the foreign exchange industry and placed its oversight under the auspices of the Commodities Futures Trading Commission (www.cftc.gov).

CFTC

The Commodity Futures Trading Commission (CFTC) was created by Congress in 1974 as an independent agency with the mandate to regulate commodity futures and option markets in the United States. The agency protects market participants against manipulation, abusive trade practices, and fraud. Through effective oversight and regulation, the CFTC enables the markets to better serve their important functions in the nation's economy, providing a mechanism for price recovery and a means of offsetting price risk. The CFTC sets forth many of the guidelines that the National Futures Association is required to follow.

NFA

The National Futures Association (NFA) officially began its operations on October 1, 1982, with the goal of maintaining the integrity of the futures marketplace. All companies trading in futures must become NFA members. Those companies that are not registered with the NFA are subject to closure by the CFTC. The passage of the Commodities Modernization Act requires that any company trading online forex be registered with the NFA. The NFA has many capital requirements and makes sure companies maintain high book-keeping and ethical standards in order to be registered. With the passage of the Modernization Act, the NFA required forex market makers to register as Futures Commission Merchants (FCMs).

Part VIII. Your Role in the FX Market

You may not realize it, but you already play a role in the foreign exchange market. Do you have some currency in your pocket or wallet? Do you have a checking or savings account? Do you have a mortgage? Do you run a business? Do you hold stocks, bonds, or other investments with a value expressed in a specific currency? A "yes" response to any of the above questions already makes you an investor in the currency markets.

When you decide to hold assets in the currency of one country, you are investing in that country's currency and economy. At the same time, you are also electing not to hold the currencies of other nations. For example, when you hold most of your portfolio (stocks, bonds, bank accounts, etc.) in US dollars, you are relying heavily on the integrity and value of the US dollar and economy, including the government that governs it. Concurrently, you are choosing not to hold the Japanese yen, British pound, or the euro.

Almost all businessmen, businesswomen, and travelers actively trade currency. If you travel overseas, you would generally exchange your own currency for the currency of the country you are visiting. In view of this, it is not surprising that more and more prudent investors are deciding to diversify their portfolios by holding assets in multiple denominations within the FX market.

Part IX. How Can Forex be Accessed?

At the most basic retail level, one can access Forex at any airport currency booth. For a service fee and a mark-up of 5-10%, one can buy or sell currencies. In fact, for many individuals, a trip to the currency exchange booth overseas is their first introduction to Forex.

Investors wishing to speculate in the FX market can now access Forex through dealers offering margin accounts as small as $300, with a price spread that is as little as 4-5 pips. High net worth individuals, corporations, or fund managers with private banking relationship should be able to trade through their banks, while corporate clients requiring the actual delivery of currencies would create a credit relationship with a Forex dealer.