The Hashemite University

**Faculty of Economics & Administrative Science**

**Department of Banking & Finance**

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Course Name: Special Topics In Finance and Insurance

Course code: 110204441

This material is prepared to cover the first topic covered in this course

Topic One: Technical and fundamentals Analysis of Stock and FOREX market.

Duration: one month

**Contents:**

* Overview.
* Spot Rate Quotation.
* Trading FOREX.
* Trading on margin.
* Why trade FOREX?
* Trading Scenarios.
* Types of Orders.
* Successful Traders.
* FOREX analysis (Fundamental vs technical).
* FOREX glossary.

**Part I: Introduction to Trading FOREX**

**Overview**

* Foreign exchange, FOREX, or just FX are all terms used to describe the trading of the world's many currencies.
* The FOREX market is the largest market in the world, with trades amounting to more than USD 3 trillion every day.
* Most FOREX trading is speculative, with only a low percentage of market activity representing governments' and companies' fundamental currency conversion needs.
* Unlike trading on the stock market, the FOREX market is not conducted by a central exchange, but on the “interbank” market, which is thought of as an OTC (over the counter) market.
* Trading takes place directly between the two counterparts necessary to make a trade, whether over the telephone or on electronic networks all over the world.
* The main centers for trading are Sydney, Tokyo, London, Frankfurt and New York.
* This worldwide distribution of trading centers means that the FOREX market is a 24-hour market.

**Spot Rate Quotations**

1. Direct quotation (figure 1)
   * the U.S. dollar equivalent
   * *e.g.* “a Japanese Yen is worth about a penny”
2. Indirect Quotation (figure 2)
   * the price of a U.S. dollar in the foreign currency
   * *e.g.* “you get 100 yen to the dollar”.

**Trading FOREX**

* A currency trade is the simultaneous buying of one currency and selling of another one.
* The currency combination used in the trade is called a cross (for example, the euro/US dollar, or the GB pound/Japanese yen)
* The most commonly traded currencies are the so-called “majors” – EURUSD, USDJPY and GBPUSD.
* The most important FOREX market is the spot market as it has the largest volume. The market is called the spot market because trades are settled immediately, or “on the spot”. In practice this means two banking days.

**Trading on Margin**

* A margin of 1.0% means you can trade up to USD 1,000,000 even though you only have USD 10,000 in your account. A margin of 1% corresponds to a 100:1 leverage (or “gearing”).
* Using this much leverage enables you to make profits very quickly, but there is also a greater risk of incurring large losses and even being completely wiped out. Therefore, it is inadvisable to maximize your leveraging as the risks can be very high.

Figure (1): Example of Direct Quotation

The *direct* quote for British pound is: £1 = $1.688

Figure (2): Example of Indirect Quotation

The *direct* quote for British pound is: £0.5924= $11

**Why Trading FOREX**

* 24 hour trading

Trade 24 hours a day from Sunday evening (20:00 GMT) to Friday evening (22:00 GMT). This gives you a unique opportunity to react instantly to breaking news that is affecting the markets.

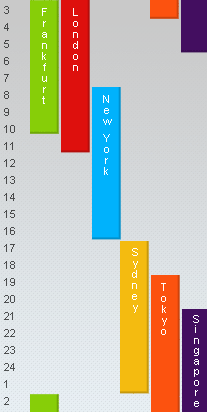


Figure (3) Worldwide FOREX trading time

* Superior liquidity

The FOREX market is so liquid that there are always buyers and sellers to trade with. The liquidity helps to ensure price stability and narrow spread.

* No commissions

The fact that FOREX is often traded without commissions makes it very attractive as an investment opportunity for investors who want to deal on a frequent basis.

* 100:1 Leverage

Leverage (gearing) enables you to hold a position worth up to 100 times more than your margin deposit.

* Profit potential in falling markets

There are always trading opportunities, whether a currency is strengthening or weakening in relation to another currency. When you trade currencies, they literally work against each other.

If the EURUSD declines, for example, it is because the US dollar gets stronger against the euro and vice versa. So, if you think the EURUSD will decline (that is, that the euro will weaken versus the dollar), you would sell EUR now and then later you buy euro back at a lower price and take your profits.

**Trading Scenarios**

1. Trading Rising Prices

|  |  |
| --- | --- |
| You buy €100,000 | EURUSD quoted at bid 0.98**75** and ask 0.98**78**, which means that you can sell 1 euro for 0.98**75** USD or buy 1 euro for 0.98**78** USD. |
| The market moves in your favor | EURUSD is now quoted at Bid 0.98**94** and Ask 0.98**96**. |
| Now you sell your euro and get the profit | You sell euro at a bid price of 0.98**94**. |
| The profit is collected | (0.98**94** - 0.98**78**)(100,000)  = $160 Profit |

If you believe that the euro will strengthen against the dollar you'll want to buy euro now and sell it back later at a higher price.

1. Trading Falling Prices

If, on the other hand, you believe that the euro will weaken against the dollar, you'll sell EURUSD.

|  |  |
| --- | --- |
| You sell €100,000 | EURUSD quoted at bid 0.98**75** and ask 0.9880, which means that you can sell 1 euro for 0.98**75** USD or buy 1 euro for 0.9880 USD. |
| The market moves in your favor | EURUSD is now quoted at Bid 0.9744 and Ask 0.9749. |
| Now you buy euro and get the profit | You buy euro at the ask price of 0.9749. |
| The profit is collected | (0.9875 - 0.9749)(100,000)  = $1260 Profit |

**Types of Orders**

1. Market Order

It is the order to buy (sell) a specific amount of a certain currency at the best available market price.

1. Entry order

An order that is executed when a particular price level is reached and/or broken.

1. Stop Entry orders

Are executed when the exchange rate breaks through a specific level. The client placing a stop entry order believes that when the market's momentum breaks through a specified level, the rate will continue in that direction.

1. Limit Entry orders

Are executed when the exchange rate touches (not breaks) a specific level. The client placing a limit entry order believes that after touching a specific level, the rate will bounce in the opposite direction of its previous momentum.

1. Stop-Loss Order

Is an entry order linked to a specific position for the purpose of stopping the position from accruing additional losses. A stop-loss order remains in effect until the position is liquidated or the client cancels the stop-loss order.

1. Limit Order:

Is a limit entry order linked to a specific position for the purpose of locking in the gains on an existing position. A Limit order placed on a Buy position is a Close entry order to Sell linked to that position. A Limit order remains in effect until the position is liquidated or the client cancels the Limit order.

**Discipline & Confidence**

**FOREX Analysis**

* Basically, supply and demand determine the value of currencies. To forecast the currency trend, there are two methodologies, which are fundamental and technical analysis.

*Fundamental Analysis*

* Fundamental analysis is Based on key economic indicators that can influence various currencies.
* Fundamental analysis studies cause of market movement.
* Fundamental analysis uses present events to predict future.
* Analysts will gain knowledge of charts analysis and indicators
* Fundamental analysis finds explanation of the current price.
* The outcome in the fundamental analysis is based on limited aspects at one time.

*Technical Analysis*

* Technical analysis is based on past performance of a currency or equity and exercise with mathematical calculations to predict future results.
* Technical analysis studies the economic effect.
* Technical analysis predicts future from history.
* Analyst will gain knowledge of awareness of the fundamentals.
* Technical analysis find accurate forecast of future.
* Outcome is based on more than 150 different type of technical analysis

**FOREX Glossary**

* Appreciation: is an increase in the value of a currency.
* Depreciation/decline: is a fall in the value of a currency.
* Ask: is the price requested by the trader. This usually indicates the lowest price a seller will accept.
* Bid: is the price offered by the trader. This usually indicates the highest price a purchaser will pay.
* Spread: The difference between the bid and the ask rate.
* Bear: Someone who believes prices are heading down. A bear market is one in which there has been a sustained fall in prices and which does not look like it will recover quickly.
* Bull: Someone who is optimistic about the market. A bull market is characterized by enthusiastic and sustained buying.
* Exchange rate: What one currency is worth in terms of another, for example the Australian dollar might be worth 58 US cents or 70 yen.
* Liquidity: The capacity to be converted easily and with minimum loss into cash. A liquid market is one in which there is enough activity to satisfy both buyers and sellers.
* Open position: A position in a currency that has not yet been offset. For example, if you have bought 100,000 USDJPY, you have an open position in USDJPY until you offset it by selling 100,000 USDJPY, thus “closing” the position.
* Short position: A position that benefits from a decline in market prices.
* Long position: A position that increases its value if market prices increase.
* Pips: A pip is the smallest unit by which a FOREX cross price quote changes. So if EURUSD bid is now quoted at 0.9767 and it moves up 2 pips, it will be quoted at 0.9769.
* Speculative: Buying and selling in the hope of making a profit, rather than doing so for some fundamental business-related need.
* Spot: A Spot rate is the current market price of an asset.
* Spot market: The part of the market calling for spot settlement of transactions. The precise meaning of “spot” will depend on local custom for a commodity, security or currency. In the UK, US and Australian foreign-exchange markets, “spot” means delivery two working days hence.