Unravelling the mysteries of FX trading

The language used in buying and selling other people’s currency is often just as confusing as the details of the trade. A new book reviewed by WAYNE HUF tries to demystify the FX market.

FX trading: An Australian guide to trading foreign exchange
By Alex Douglas, Peter Pontikis and Larry Lovrencic
Wrightbooks, Australia, 2005

Ask any two experts in any two industries to sit at a table and describe to each other the inner workings of their respective disciplines and neither is likely to have the faintest idea what the other is really talking about. Every industry has its own jargon – a language which only those at the heart of their industry will understand.

In the introduction to this book, the authors make the following statement: “The aim of this book ... is to explain and demystify the characteristics and terminology that are unique to the foreign exchange market”. This book certainly does that.

It is a well-assembled collection of concise, easy-to-understand topics within broader chapters which could easily be used as a reference text for specific queries and clarification on future occasions. One such purpose would be to decipher much of the industry speak and jargon in news and magazine articles.

It provides a brief history of the global FX market and how it evolved from traders passing along the Silk Road on their journey through to today's sophisticated and high-speed, decentralised and highly deregulated platform. It describes the key players within the market – from banks and brokers to institutions, hedge funds through to central banks – what they do, how they interact – even how they speak. It describes the various trading and information platforms available – from the “top end of town” to the home trader. It explains the key market sectors – the most active markets, currencies and time zones and explains the standardisations within the market allowing trading to occur at the click of a mouse at virtually any point on the planet. It explains the methods traders use in an attempt to anticipate market movement. It explains some of the fundamental factors which influence rates, including interest rates, economic data, regulatory issues and a range of graphical historical data to highlight trends and relationships. It devotes a chapter to technical analysis (charting) – an increasingly important consideration in this age of widely available trading and market data. It provides an excellent overview of currency options and how simple trading strategies can provide a good risk/reward balance. Finally, it provides an introduction to some of the tried and tested methods for taking, managing and profiting from risk, and explains concrete facts about some of the bear-traps in the market – like “slippage” on stop losses.

A theme commonly mentioned in the book is the importance of effective money and risk management as a building block to long-term financial success. No trader wins every time – not even the big guys. So, what do you do when things don’t go exactly to plan? This book provides the fundamental knowledge required to identify risk. More importantly, it discusses the decision process behind the allocation of financial resources. For example, what proportion of my capital will I allocate to this trade? What are the implications for my liquidity if this trade does what is expected/not expected? What are the implications for a string of losing trades? Furthermore, it discusses some of the daily administrative processes in FX trading – for instance forward rolls, carry trades and position funding.

While this book is targeted at entry-level participants into the market, it is certainly not one of those “get rich quick” books. It is too balanced for that. In fact, it would have just as much appeal to a junior trader at a trading bank looking to fill in a few information gaps as it would a “mum and dad” trader wanting to understand a bit more about FX risk in their portfolio. It provides many anecdotes like: “Trade your market, not your opinion of the market” and encourages a disciplined and informed approach to trading.

It quotes: “Risk is not something that should be avoided – it should be understood, mitigated and profited from.” Again, it does this in clear and non-ego-driven manner.

Even though this is the type of information seasoned traders should be able to rattle off without too much effort, nothing will teach you more about the markets than to actually get amongst it and trade. The more you are in contact with the markets the more you will learn – but this book gives a good overview of the threads you should follow.

Keep this book handy on the nearby shelf – you may find yourself picking it up more than once.

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