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HOW IS MONEY MADE IN THE FOREX MARKET

In the Forex market, you buy or sell currencies. The idea is that you exchange one currency for another with the expectation that the price will change in your favour. So the currency you bought will increase in value compared to the one you sold.

Here's an example

TRADE	EUR	USD
You purchase 10'000 Euros at the EUR/USD exchange of 1.1800	+10'000	-11'800
Two weeks later you exchange your 10'000 Euros back into USD at the exchange rate of 1.2500	-10'000	+12'500
PROFIT TAKEN OF \$700		

When taking leverage into account, profits could be much higher. Exchange rate is the ratio of one currency valued against another currency.

HOW TO READ A FOREX QUOTE

As usual, we will be using the GBP/USD. This information will apply to any of the currency pairs that you decide to use.

GBP / USD =

Base Currency

Quote

The first currency mentioned in the quote is the **base currency**. The second (after the slash) is the **quote currency**. In the above figure, we are showing that 1 British Pound is worth 1.6050 US Dollars.

So if at this point you decided you want to trade on this exchange rate, and you felt that the GBP would increase in strength, you will then **buy**. When trading we always refer to what you are doing with the **base currency**. Because if you feel the pound with strengthening, you want more of them, so you buy pounds.

If you decided that the pound would weaken against the dollar, you would **sell**. You want to get rid of them and rather stock up with dollars.

HOW TO READ A FOREX CHART – THE BASICS



What is there to take note of on the Forex charts ?

- Currency Pair
- Chart period
- Current Exchange Rate
- Any obvious trend?

Usually, on charts, it will show what currency pair you are trading. You'll see on the top left of this chart it shows I am trading the GBP/USD. The H1 next to the currency pair shows us that it is the 1-hour chart. This means that each candlestick represents one hour. Don't worry, we'll cover more about candlesticks soon.

The vertical column on the right shows the values of the currency, in this case, the black background block shows the current exchange rate. And we can clearly see over this period that there was a big long movement. Long meaning going up. This shows us that the British Pound is hammering the US Dollar. At least over this small bite of the market.

IMPORTANT FOREX TERMS

LONG VS SHORT

Traders like their lingo. A long position or a short position has nothing to do with time. Long means that they are **buying** the base currency, and short means **selling** the base currency.

So if you hear someone saying they are “entering a short position” or “going short” they are basically entering a trade by selling. “Going long” or “entering a long position” is when they are entering a trade by buying the base currency.

But why do traders use these terms? It’s a fairly simple answer when you consider that traders can make money in either direction. For example, suppose you walk into my office and ask me what sort of trade I will be making today. I tell you that I am going to sell today.

By saying that I am going to sell, I am not being clear because that can have two different meanings. Perhaps I am going to sell a currency pair that I had previously purchased, thus closing an existing trade. Or it could mean that I am opening a new short trade.

However, if you ask the same question and the answer is that I am going short, there can be no confusion as to what it means.

The same applies to buying. If I say that I am going to buy, it could mean that I am either opening anew long trade or that I am now buying back currency that I had previously sold and am therefore actually closing an existing trade.

But if I say I am going long, then there can only be one meaning.

BID / ASK

All Forex quotes are quoted with two prices. The **bid** and **ask**. The bid is the price at which your broker will buy the base currency, and the ask is what they will sell the base currency. The difference between the bid and ask price is known as the **spread** and this is where brokers make their money.

Brokers **bid** prices will be a little lower than the value of exchange so when they buy back the currency they make a small profit. The **ask** price is a little higher than the exchange value, so when they sell you the currency they make a small profit.

This is actually a very good system, so there are no fees or commissions payable to brokers and your spread is included in your trade immediately. So you can cover your costs immediately.

WHAT IS A PIP?

Have a look at the above graph, and the section on how to read Forex quotes. You will note that we use 4 decimal places instead of the regular two. Nothing is smaller than 1c right? Wrong.

A pip is 1/100th of a cent and this is where Forex traders make their money. Let's take the exchange rate from the previous graph of 1.6069.

1, | 6 | 0 | 6 | 9

6

- 10 cents = 100 pips



0

- 1 cents = 100 pips



6

- 1/10th of a cents = 10 pips



9

- 1/100th of a cents = 1 pip

So if the market moves from 1.6069 up to 1.6089 it means it moved 20 pips up, or you could say the pound strengthened by 20 pips.

Depending on how much you traded, this could be a small amount of profit or a lot. With a \$5'000 dollar account, you could trade \$10 a pip and make \$200 off a small trade like that. It should be noted again that Forex trading is a risk, and if you went the wrong way you could also lose \$200 on a trade like that.

The next section covers Lots, Leverage, Profits, and Loss which will help you understand how we make money from pips. **Important Note:** Some brokers will offer a 5th decimal place, and these are called **Fractional Pips**. They are also nick-named a **pipette**.

LOTS, LEVERAGE, PROFIT AND LOSS

In the introduction of this document, we showed that the minimum amount allowed used to be \$100'000 per trade for this type of Forex trading. With the opening of the retail sector, these lots have been divided up making it more accessible to the general public to start trading.

LOT SIZES

LOT'S NAME	NUMBER OF UNITS
Standard	100'000
Mini	10'000
Micro	1'000
Nano	100

Micro lots seem to be a very popular account size for people starting out, and most brokers will allow Micro accounts. Not many allow Nano accounts purely because it's not worth their while.

LEVERAGE

Leverage is one of the best (and possibly worst) things about Forex trading. If you think of your broker as a bank that is fronting you the money to purchase currencies, all the bank is asking is that you give it a smaller amount as a good faith deposit.

If your broker offers a 100: 1 leverage, then for every 1 unit you put in, the broker will let you trade 100 times that amount. In this example, if you wanted to trade a Micro lot (1'000 units) you could put down 10 units at 100:1 leverage. Make sense?

Simply put, here's an example of profit/loss on a trade. So let's say you wanted to trade \$100'000 on the USD/CHF pair, and you agreed on a 100:1 leverage with your broker. You would put down \$1'000 to secure the temporary loan and the broker would let you trade with \$100'000 value. For every pip movement on this amount, you would make or lose \$10.

LIQUID

A liquid or a thick market is a market in which selling and buying is done quickly and easily. This is because there are more people trading in the market, so there is more likely to be someone who wants to buy what you are selling, or sell what you are buying. Simply put, here's an example of profit/loss on a trade. So let's say you wanted to trade \$100'000 on the USD/CHF pair, and you agreed on a 100:1 leverage with your broker. You would put down \$1'000 to secure the temporary loan and the broker would let you trade with \$100'000 value. For every pip movement on this amount, you would make or lose \$10.

A market with very few buyers and sellers is referred to as an "illiquid" market.

SUPPORT

Support is a point on the chart where we have seen the market often stop falling. It is not an exact point, but generally an area. The tighter the points are the stronger we generally see the support line. In the below example, we have a support line drawn in that has been hit several times, even having a breakthrough in the middle section.



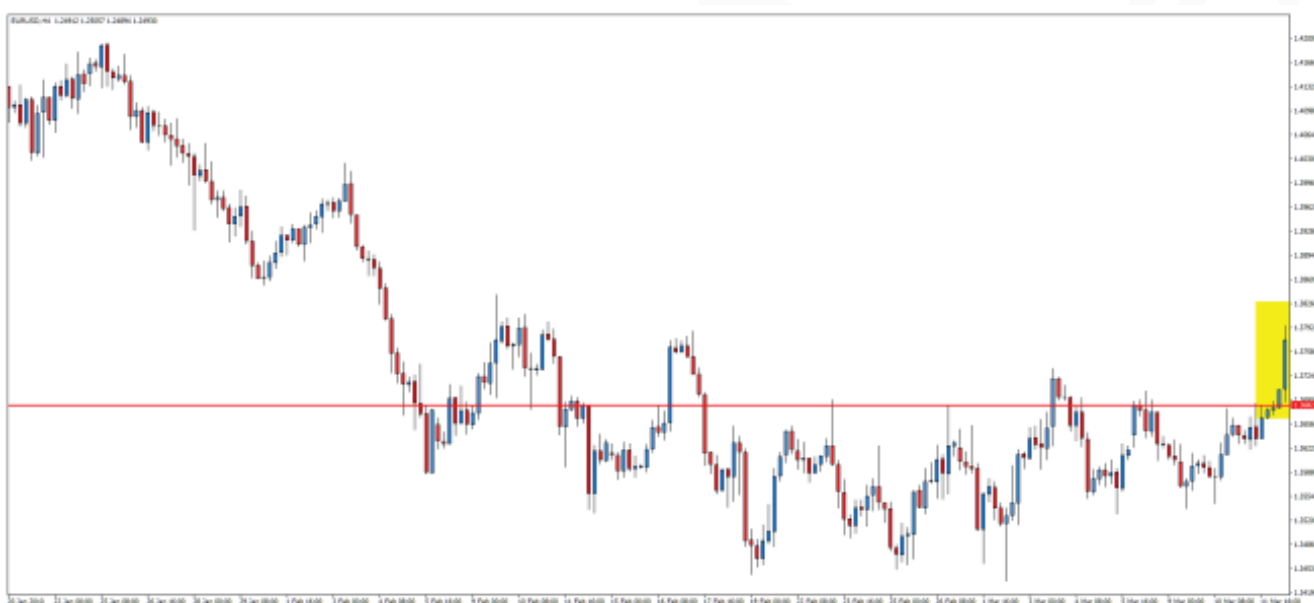
RESISTANCE

This is the polar opposite to the support line. Instead of us seeing the market stop falling, this is where we see the market stops rising. It is also not an exact price, but an area above.



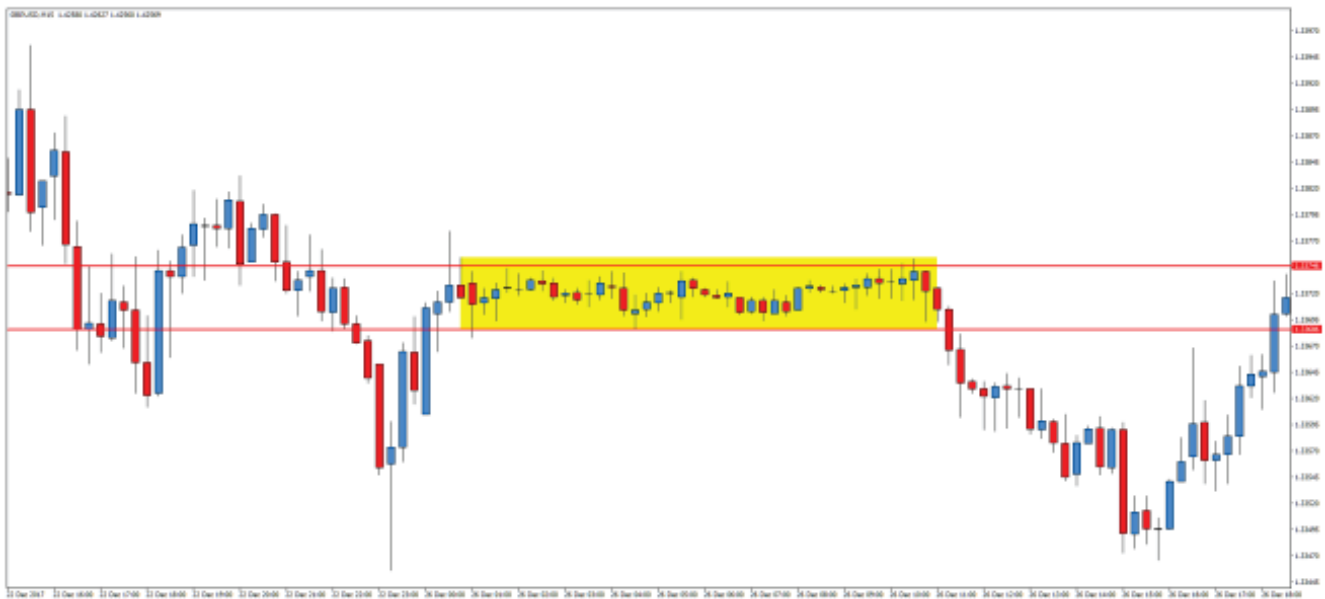
BREAKOUT

A breakout occurs when the exchange rate breaks below a support or above a resistance line.



RANGE

A range occurs when the exchange rate is moving more sideways, rather than moving in a clear direction. It is contained within visible support and resistance levels.



CONSOLIDATION

Consolidation occurs when the exchange rate is moving in an area that is getting squeezed or narrowing. The consolidation times often lead to breakouts.





Welcome to the Vault Markets Hub, our team is made up of experienced and passionate International traders from within the Forex industry. Strategically combining their expertise to focus on developing and empowering African Forex markets to compete at a Global scale. We've got over 40 years of combined experience in our Vault, that we are sharing with our valued Brokers and clients, to support their success and the prosperity of Africa as a whole.

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