Forex Trading - Five Keys to a Profitable Trading Strategy

The Forex (Foreign Exchange) market is among the largest financial markets in the world with turnover every single day estimated to run up to $3 trillion. And if you hope to unlock the riches in the Forex trading market, you'll need to know what you're doing. Here are five crucial keys you can use to build a profitable trading strategy.

Key One: Know your market.

The surest way to gain an advantage, maximize profits and minimize losses is to know the market and how it works... know it like the back of your hand. The Forex market was originally a playground for the big boys (and still is). Players include commercial banks, central banks and multinationals engaged in foreign trade, as well as giant investment funds, and broker companies. In addition, private individuals with very large capital assets are typical participants. But more and more smaller players are entering this market. If you want to be one of them, it is essential for you to know the territory and the rules. In other words, you absolutely must have a profitable trading strategy from the outset.

Assets in this market are highly liquid, and they can be converted from one currency to another literally at the speed of light over the Internet.

More traders engage in this business than in any other form of trading. Two big attractions, especially for individuals, are the lack of membership fees and the lure, always there in the background, of big, big profits.

Trading is done in pairs, with the most commonly traded currency pairs being the US Dollar / Japanese Yen, the Euro / US Dollar, and the Swiss Franc / US Dollar. In Forex trading, everything is intangible and virtual. No actual product is ever sold or bought, and no money changes hands until a trader cashes out the gains from his account. All activity consists of computer entries made on the value of one currency against another. Say, for example, you use US dollars to buy Euros, expecting that the Euro will go up. When its value rises, you can then sell those Euros for dollars, and this difference earns you a profit.

Key Two: Learn the language.

There are three concepts you need to know in the currency market. Pips refer to the increase of one hundredth of a percent of the value of the currency pair you are trading. In the amounts traded, each pip may typically have a value of $1 or $10. Volume is the quantity or amount of money being traded at one particular time in the market. Buying is the acquisition of a particular currency. A trader buys with the hopes that the price of the currency will increase. Selling is putting your bundle of currency out for someone else to purchase because you expect a possible decrease in its value.

There are also two different kinds of analysis usually used in currency trading technical analysis and fundamental analysis. Technical analysis is usually used by small and medium players. Here, the analysis concentrates on patterns of price activity. In contrast, fundamental analysis is often used by larger companies and players who work with bigger investments. This type of analysis is more complex and looks at many other factors that can influence the value of a currency. With fundamental analysis, the investor carefully watches the situation in the currency's issuing country, including such issues as political stability, tax policies, inflation rate and unemployment rate. These factors are known to affect currency value.

Key Three: Learn (or develop) a solid trading strategy.

The trading strategy you settle on should be closely matched to your personal characteristics, and thus, what kind of Forex trader you are. An ideal trading strategy would also prevent (or rather minimize) losses.

Your strategy should take into account the size of your transactions. Conducting a lot of different trades is generally more successful than lumping everything into one giant trade. This approach fosters discipline, and it also spreads out the risk, lowering the possibility that any one loss will wipe out a large chunk of your capital. The basis of any good trading strategy is a combination of discipline and smart money management.

Key Four: Get lots of practice at the beginning.

Be sure to do paper trading until you thoroughly understand how everything works. This is a great way to build your trading skills, learn how the market functions and get comfortable with the software and tools you'll be using. Of course, paper trading cannot prepare you for the emotional ups and downs of watching big waves of money leaving your account or rolling into it. That only comes when your own actual money is on the line. However, paper trading will build the daily skill sets you'll need for investing. A number of brokers offer trial accounts with free paper trading. Use one or more of them. They'll give you practice and experience before you dive in and risk your own money.

Key Five: Choose a Forex dealer who is a good match for you.

Do your due diligence... check that they are registered and in good standing. And check their reputation around the industry. Stay very far away from any dealer whose investment schemes defy logic and just sound too good to be true. Often the dazzling, over-the-top offers and the breathless, hyped-up sales pages are plenty of warning. Always be sure to carefully vet any investment offer - and then sleep on it - before you get started.

Forex trading may seem easy and manageable. But the emotional stress, the demands and challenges of being a Forex trader, requires more than just the knowledge of the market. It requires more than just a keen and sensible head for business. It's all about a game plan. And for that, you'll definitely need a profitable trading strategy.

About the Author

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