Risks of Trading in Forex Market

Although every investment involves some risk, the risk of loss in trading off-exchange forex contracts can be substantial. Therefore, if you are considering participating in this market, you should understand some of the risks associated with this product so you can make an informed decision before investing.

As stated in the introduction to this booklet, off-exchange foreign currency trading carries a high level of risk and may not be suitable for all customers. The only funds that should ever be used to speculate in foreign currency trading, or any type of highly speculative investment, are funds that represent risk capital i.e., funds you can afford to lose without affecting your financial situation. There are other reasons why forex trading may or may not be an appropriate investment for you, and they are highlighted below.

The market could move against you

No one can predict with certainty which way exchange rates will go, and the forex market is volatile. Fluctuations in the foreign exchange rate between the time you place the trade and the time you close it out will affect the price of your forex contract and the potential profit and losses relating to it.

You could lose your entire investment

You will be required to deposit an amount of money (often referred to as a security deposit or margin) with your forex dealer in order to buy or sell an off-exchange forex contract. As discussed earlier, a relatively small amount of money can enable you to hold a forex position worth many times the account value. This is referred to as leverage or gearing. The smaller the deposits in relation to the underlying value of the contract, the greater the leverage. If the price moves in an unfavorable direction, high leverage can produce large losses in relation to your initial deposit. In fact, even a small move against your position may result in a large loss, including the loss of your entire deposit. Depending on your agreement with your dealer, you may also be required to pay additional losses.

Overtrading is another ordinary money management mistake in the forex market. This trading does not have clearly defined trading objectives; the sole reason is to make more money. To avoid this mistake, make sure that every trade is broken into ultimate goals, and that these goals are achieved before other positions are added. Very few traders can successfully manage multiple positions in a variety of currency trading markets.

Overconfidence is a big mistake when it comes to money management and the forex market. This is caused when a trader has or thinks they have particular or inside information. These hot tips are sometimes wrong, and when this happens large amounts of money may be lost because of this. The way to avoid this is to avoid being confident in any rumors or special information you may have. Managing your money means taking measures to preserve it as well.

Preferential bias can exist among forex market traders. This happens when they only see or hear what they want in relative to the favored trade. This can cause a trader to ignore the real activity of the forex market in favorite of what they want to happen. It is important to look at each trade impartially and do not become set in cement with your opinion. Do not ask friends or family for their opinions; just go with what you know.

About the Author

I am Rahul Patel a freelance writer SEO Web Designer with deep interest in forex trading. I have written online forex trading articles and published many of them online. I have designed website on currency trading guide.