How to Protect Yourself When Trading Forex

Description

Foreign currencies have been all over the news recently, and there were some clear trends in 2015, the USD appreciated while Australia, Japan and China's currencies were on a downward slide. I already expected these because of a very simplistic fundamental analysis on a macro level, although that alone wasn't enough to trade profitably. During this period, some readers have also been asking me about my thoughts on forex.

I've been hesitant to share since I'm more of a long-term investor than a trader, but I finally decided that while I may not be able to stop someone who wishes to trade, the least I can do is to help educate on the pros and cons of the game. The rest, is ultimately up to the individual.

Frankly speaking, if you can manage the risks that forex trading carries, then you can potentially benefit from the trades, and there are folks who get rich from forex trading (I know a number of such people). However, if you're an emotional person who finds it hard to stomach losses, then the volatile forex market may not be the best for you.

Why are so many people drawn to forex trading? Folks I know who trade foreign currencies have been drawn for various reasons. The biggest appeal lies in the fact that **you don't need a lot of capital before you can start.** Because of leverage, a $500 margin deposit can enable you to buy $25,000 worth of currencies (using a 50-to-1 leverage). **There are also no brokerage commissions** (except for direct market access); the only fee you need to pay is the bid-ask-spread – the difference in price between the buying and selling price.

Unlike stocks, there's no central exchange for forex transactions. Instead, currencies are traded by a global network of banks, dealers and brokers, which allows for **24 hour trading on weekdays** . One downside I've experienced while investing in the stock markets is that there's a fixed trading window. In Singapore, the market opens at 9am and closes at 5pm – most of us are usually at work during these hours!

For the lazy ones, **forex also requires less homework than equities**, since you only need to study a few currencies in contrast to thousands of stocks.

However, while forex is the largest financial market in the world, the massive amount of money being traded also makes it one of the most volatile. **Some people make massive profits within seconds, whereas others suffer devastating losses.** With a good online trading platform, you can set it to automatically close your position once your desired profit level (a limit order) or when the maximum loss you can afford (a stop loss order) has been reached. A word of advice – if you choose to trade forex, greed and emotions will kill you, and that's where the biggest danger lies.

Thus, if you really wish to trade forex, it is essential to learn how to protect yourself.

Tips on protecting yourself while trading forex

1. Trade only with reputable forex brokers.

Check what other traders are using before you decide which one to go with. For instance, in Singapore, a lot of traders and investors alike typically attend Invest Fair (an event organized by SPH's subsidiary) to glean more knowledge. You could check which were the most preferred forex providers voted by visitors for the past years and go with these trusted names.

Some providers such as IG also provide an online community that you can join, where you can share and discuss the latest trading news and analysis with other like-minded traders.

2. Get educated first!

As you can tell, there are various risks to trading (whether it be forex or CFDs), and educating yourself will be the most valuable tool in helping you to maximize your profits and minimize your losses.
Most reputable providers will often invest in value-added services for their clients, including educational programmes and trainings. For instance, IG offers a Trading Track with classes for beginners, intermediates and expert traders to progress their skills. I recently bought into Riverstone and looked at the general sentiment towards this stock as one of the criteria before I entered.

3. Avoid exotic currencies.
They're more volatile in price movements and harder to predict as well. If you really want to trade, look at major currencies like the USD, EUR, AUD, JPY and GBP.

4. Be careful of leverage.

Leverage is truly a double-edged sword – it can bring you great profits but devastating losses as well if you're not careful. Price movements in forex are measured in pips, and the value of each pip depends on how much leverage you apply. The higher your leverage, the higher the value of each pip. If you gain pips, you earn the equivalent as profits, whereas if you lose pips, you similarly pay the equivalent as losses.

5. Never risk more than 2% per trade.
A trader friend of mine who makes a living out of trading forex once told me that his golden rule is to never risk more than 2% per trade. While this limits his profits, it also helps to limit his losses. If you're looking to trade because you're greedy for returns, this greed could work against you and that's exactly how many people lose their life savings as a result.

6. Trade with your brain, not with your heart

Finally, the biggest tip I've gotten from experienced traders is to trade logically and not emotionally. We've all seen (or at least in movies) the gambler at the casino who is losing money stays on and borrows just so he can continue gambling because he believes he can't be so unlucky for long, and his next game will be the winning one, thus betting higher and higher stakes as he goes on. We all know how that usually ends.

Be careful and be smart.

With love,

Budget Babe

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