August 28, 2009

Vijay L Bhambwani

Tel –

91 - 22 - 23438482

E-mail –

vijay@Bsplindia.com

Url –

www.Bsplindia.com

Snail mail –

Bhambwani Securities (P) Ltd

5 Kala Niketan
47-C Warden Road
Mumbai 400 026
India

Forex Trading demystified – part 1 of 6

The Indian trading fraternity opened it's doors to forex futures last year and ushered in an era that is likely to trigger a sea change in the traded futures markets. Globally, the turnover in forex markets is second to none as the intraday volatility is very narrow and therefore traders are compelled to initiate trades on high exposure to make similar amounts of money as they would have in small sized exposure in equity futures. In terms of turnover, the following is the pecking order -

1) Forex
2) Commodities
3) Equities

In the Indian context unfortunately, the trader assigns importance to these markets in the inverse order of preference ! Through this series of articles, I intend to clear the air about the potential, risks, rewards and the tools required to master this challenging but profitable avenue of trading.

First things first - forex markets are NOT similar to equity markets and cannot be treated with similar mindsets. The difference is not just in the traded hours of these exchanges alone. Where equity markets trade between 9:55 am - 3:30 pm, the forex markets are relatively trading longer hours : 9 am - 5 pm. Clearly, this market demands a lot of stamina and endurance from the participants. The stark difference between equity and forex markets is the tick size per trade and the resultant mark-to-market impact of every tick on the trader. Currently, Indian forex markets allow the USD (US Dollar) only and the market lot is USD 1000 per trade. Traders with higher risk appetite may initiate trades in multiples of 1000 USD. In terms of capital investment, the span margin requirement is 1.75 % on the trade initiatiation day and 1 % on subsequent days. The logic in lower subsequent margins being the mark to market payout that a trader would pay at the end of the first session to cover the market risk. In terms of leverage, the trader has a "full throttle" 100 times leverage as compared to 6 times in equity futures, 8 times in Nifty futures and 20 times in commodity futures. How is that in terms of "more bangs for the buck" ?

The tick size is 0.0025 (decimals known as "pips" in forex trading parlance). Therefore, with every tick change in the price quote, the trader will witness a Rs 2.50 change in capitalisation of his / her exposure. In terms of tenure, the contracts are monthly in tenure and allow upto 12 months of exposure to a trader, depending on the traders individual perspective. Contrary to popular misconceptions, the contracts are cash settled (you do not have to give / take delivery of USD) at the INR / USD reference rates as announced by the RBI. The monthly contract ends two days prior to the last business day of every month, at precisely 12 noon. For example, if the last business day of Sept is 30 th, the Sept USD contract will expire on 28th Sept 2009 at 12 noon.

Now that you are familiarised with the nuts and bolts of the business, let us examine the issues of offline / online trading. In the good old days, you called a stock broker and placed a buy / sell order on the telephone. That may / may not work in commodities. It will certainly NOT work in forex ! You are measuring your profits in "pips" and you cannot afford to let "slippage" eat away your gains due to lax order entry. Online trading is the only effective way to trade for a professional forex trader. Forex traders literally measure their lives in terms of heart beats and therefore, the margin of error is virtually nil in this trade. With leverage of 100 times, any error tends to be larger than life itself.....

To be contd in parts 2 through 6

Vijay L Bhambwani
(Ceo - BSPLindia.com)

The columnist is the author of "A Traders Guide to Indian Commodity Markets" and invites feedback at vijay@BSPLindia.com.