

“How to Swim the Forex Ocean...and Not Get Eaten by Sharks”

Kevin J. Davey

kdavey@kjtradingsystems.com

I must be an idiot. The kind of person who drives the wrong way on a one way street. Someone who pushes a door to open it, instead of pulling the handle. A plain old idiot.

Why do I put myself in this class? Simple – the FOREX market.

I never realized the FOREX market was as easy as following some color coded signals, clicking the mouse, and counting the profits. All these years I could have been making enormous amounts of money - so easily a child could have done it. I should stop being an idiot and just attend the free FOREX seminar (conveniently located at a local hotel), and learn what I've been missing.

Sure, I finished second in a worldwide futures trading contest in 2005 with a 148% return, but it took nearly 15 years to get to that point, and even today futures trading is a constant emotional and mental struggle. I should have been trading FOREX all along, since everyone on television and in direct mail tells me it is so easy.

Except, its not that easy.

In reality, FOREX is an ocean of professional traders (the sharks), just waiting to devour the little minnows and sardines. And if you haven't figured out who the minnows and sardines are, well, my friend, just look in a mirror.

So, how can you evolve from minnow status into full fledged shark? My 15 years of speculating experience, primarily in the futures market and more recently the FOREX market, points to three major areas: knowing the market, knowing the competition and knowing your plan of attack. Do all three, and your chances of avoiding the sharks rises like the ocean tide. Neglect these areas, and you become bait.

Know the Market

The first step to swimming the FOREX ocean is knowing what the waters are like. Do you know what a “pip” is? If you do, can you calculate the pip value in US dollars for the EUR/USD pair? What about the EUR/JPY pair? If not, you need to get the basics down first.

Take time to learn. We'll talk about competition later, but rest assured, your competition knows all about the FOREX market. Where do you learn about FOREX? Websites and books abound on the FOREX market – it is a good idea to read a few of these books, and use the Internet to find good educational (not just sales hype) sites.

One key item to learn is regarding transaction costs. Even though most FOREX dealers do not charge commissions if you make your own trading decisions, there is still a

trading cost, called the bid/ask spread. This spread can range from \$20 to \$80 per trade, and is something you obviously have to overcome in order to be successful. All things being equal, trading pairs with small spreads is the best way to go.

Once you do enough research, you probably will come to the conclusion that you should focus your efforts on the major currency pairs, ones that include the US Dollar, Japanese Yen, British Pound and Euro. FOREX pairs with these currencies typically have the lowest spreads, the highest liquidity, and the most fundamental information available. But don't take my word for it – research the market until you feel comfortable with whatever pairs you want to trade.

Know Your Competition

Why should you bother to know your competition in the FOREX market? Simply put, FOREX is a zero sum game – for every dollar someone wins, someone else loses that dollar. Wealth is only created for some by taking from others. It is not like the stock market, where almost everyone (except a small amount of short sellers) benefits from rising stock prices. FOREX is definitely not “win/win,” but rather “win/lose.” Knowing this rule, and recognizing your competition's tendencies, can help give you an edge.

Who are the major players in FOREX? Banks, hedge funds and multinational corporations are all big players, and they make a lot of money from FOREX. One car company recently attributed a large portion of its profit to FOREX activities. These groups should strike fear into little minnows, because these groups are the professional sharks. They trade day and night, know the ins and outs of the market, and eat the weak. Big moves are usually due to professionals, so following their lead and following trends they start may be a good strategy.

In the same waters the professional sharks swim, there are also a lot of minnows. They are also your competition, so knowing their tendencies can help you exploit them. For example, unsophisticated minnow traders are likely to put stop losses in obvious support or resistance levels. Knowing this, you can exploit this tendency and feed on them. Also, think about the first “sure thing” chart formation you ever learned about. Chances are new traders are just learning about that formation now, so you could fade their trades and likely do alright.

Think of it this way – defeating a foe who is sitting in his home office trading FOREX in his bunny slippers is probably easier than defeating an MBA with a \$5000 suit who trades via complex neural network arbitrage programs. So, try to mimic and follow the sharks, and eat the minnows. This is where having a plan (to make you a more agile minnow, or even turn you into a shark), is critical.

Know Your Plan of Attack (Take Steps To Not Be a Minnow)

Once you really know the FOREX market and really know the competition, chances are you will be very scared. If you aren't scared, you probably need to go back to steps one

and two, and spend more time learning. The FOREX market is very difficult, and you are a minnow swimming in some deep waters. Don't kid yourself into thinking FOREX trading is easy.

Once you realize that FOREX is tough work, you are ready to determine your plan of attack. There are really two ways to do this – either on your own, or with an advisor.

If you decide to do it on your own, plan on spending at least 500-1000 hours of your time, and \$2-5K for software, books, seminars, etc. Like it or not, that is what it takes to develop a good trading system. If you try to shortchange this effort, your trading results will likely reflect that fact. You get out only what you put in.

An alternative is to use an advisor, or an advisory service. This will take less time than doing it on your own, but you must be willing to perform due diligence on any advisor you find. Blindly following signals from an unknown Internet service, or turning your money over to an unknown advisor, is a sure way to lose your money.

Conclusion

So there you have it – a brief overview of how to swim the FOREX waters. The key, I have found, is to treat FOREX trading as a business, not as a hobby. Take the time to really understand the markets and what moves them. Realize that you are up against professionals who will take advantage of any weakness in your trading system or your trading psychology. Finally, have a plan, and be willing to invest the time and money to develop your plan. If you perform all three of these tasks, you might just find yourself surviving the waters of the FOREX ocean.

Happy swimming!

Kevin Davey finished in 1st place in a worldwide futures trading contest in 2006, with a 107% return. In addition, he finished in 2nd place in a worldwide futures trading contest in 2005, with a 148% return. Kevin can be reached at kdavey@kjtradingsystems.com.