Foreign Exchange and Commodities

Contents

The Foreign Exchange (FX) Market

The FX market is the largest and most liquid market in the world

- Approx. USD5 trillion of trading volume per day
- USD makes up majority of FX volume
- FX traded mainly by investors/speculators; but also banks, businesses, and governments

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The FX Market

FX Spot Market

- Trades 24 hours a day, 5 days a week.
- Global
- No central location or exchange. Trades over the counter ("OTC").

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FX Trading

How is FX used?

- To enhance portfolio returns
- Speculation
- Risk Management
- Diversification

The FX Market

What impacts how a country's currency trades versus other currencies?

Interest rates
Inflation
Trade deficits
Monetary policy
Purchasing power parity

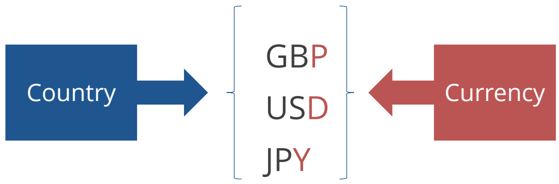
Supply and demand
Speculation
Central Bank policies
Recession/Expansion
Political stability
Rumors

Foreign Exchange Definitions and Quote Methodology

Every currency is referred to by 3 letters.

First 2 letters refer to the country.

Last letter or symbol refers to the currency name.



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Foreign Exchange Definitions and Quote Methodology

Currencies are priced in relation to another currency so they are always quoted in a pair.

A pair can be quoted like this: 1.2742 EUR/USD

or

like this: EUR/USD = 1.2742

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Foreign Exchange Definitions and Quote Methodology

Currency on the left is the base currency. The base currency is always equal to 1.

1.2742 EUR/USD

or

EUR/USD = 1.2742

Currency on the right is the quoted or counter currency. It is what the base currency is equivalent to in that currency.

In other words, 1 EUR can buy 1.2742 USD

Foreign Exchange Definitions and Quote Methodology

1.1284 EUR/USD or EUR/USD = 1.1284	You can buy one Euro with USD1.1284. If you sell one Euro, you can buy USD1.1284.
110.854 USD/JPY or USD/JPY = 110.854	You can buy one US dollar with 110.854 yen. If you sell 110.854 yen, you can buy one US dollar.
1.00055 AUD/CAD or AUD/CAD = 1.00055	You can buy one Australian dollar with CAD1.00055. If you sell 1.00055 Canadian dollars, you can buy one Australian dollar.

If you are buying the base currency (because you expect it to appreciate), you are selling the quote or counter currency.
If you are selling the base currency (because you expect it to depreciate), you are buying the quote or counter currency.

Commonly Traded Currency Pairs

EUR/USD	Euro and US dollar
USD/JPY	US dollar and Japanese yen
GBP/USD	British pound and US dollar
USD/CHF	US dollar and Swiss franc
AUD/USD	Australian dollar and US dollar
USD/CAD	US dollar and Canadian dollar
NZD/USD	New Zealand dollar/US Dollar

Foreign Exchange Definitions and Quote Methodology

With EUR/USD=1.2815, EUR is the base currency.
The inverse of this currency quote is
USD/EUR in which USD is the base currency.
Inverse quote: 1÷ 1.2815 = 0.780336 EUR per USD
or
USD/EUR=0.780336

Foreign Exchange Spot Market

Market quotes have a "bid" side and an "ask" side.
The bid side is the price at which you can sell the base currency.
The ask side is the price at which you can buy the base currency.

ASK: the price at which you can buy Euros

EUR/USD 1.2742/1.2745

BID: the price at which you can sell Euros

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Foreign Exchange Spot Market

A standard contract is 100,000 units.

Forex Quotes from TradingCharts

Select Currencies | Open / Close based on: Last 24 hours | Ref

Symbol	Bid	Ask	High	Low	Open	Change
EUR/USD	1.3348	1.3350	1.3359	1.3310	1.3313	0.0035
USD/JPY	82.07	82.10	82.33	81.84	82.29	-0.23
GBP/USD	1.5977	1.5980	1.5986	1.5954	1.5955	0.0022
USD/CHF	0.9029	0.9032	0.9056	0.9021	0.9054	-0.0025
EUR/GBP	0.8354	0.8356	0.8359	0.8340	0.8342	0.0012
EUR/JPY	109.58	109.59	109.87	109.03	109.55	0.02
EUR/CHF	1.2053	1.2057	1.2056	1.2049	1.2055	-0.0002
AUD/USD	1.0401	1.0404	1.0413	1.0368	1.0373	0.0028
USD/CAD	0.9959	0.9963	0.9969	0.9951	0.9968	-0.0009
NZD/USD	0.8192	0.8196	0.8199	0.8165	0.8170	0.0022

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Foreign Exchange Spot Market

If you expect the base currency to appreciate versus the quoted currency, you would:
- Buy or go long the base currency
- Sell or go short the quoted currency

If you expect the base currency to depreciate versus the quoted currency, you would:
- Sell or go short the base currency
- Buy or go long the quoted currency

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Foreign Exchange Cross Rates

Direct currency quote
- A currency pair in which the domestic currency is the quoted currency
- If CAD is the domestic currency, USD/CAD is a direct quote.

Indirect currency quote
- A currency pair in which the domestic currency is the base currency
- If CAD is the domestic currency, CAD/USD is an indirect quote.

Cross Rate
- A cross rate is the exchange rate between two currencies when neither is the domestic currency.
- Also refers to any quote not involving the USD. e.g. EUR/GBP

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Foreign Exchange Cross Rates

With a cross pair, you are selling one currency for USD and using that USD to buy the other currency

How are cross rates priced?

e.g. EUR/JPY

EUR/USD

& JPY/USD

are common pairs

EUR/JPY is priced off of these 2 common pairs

A cross pair is essentially 2 transactions

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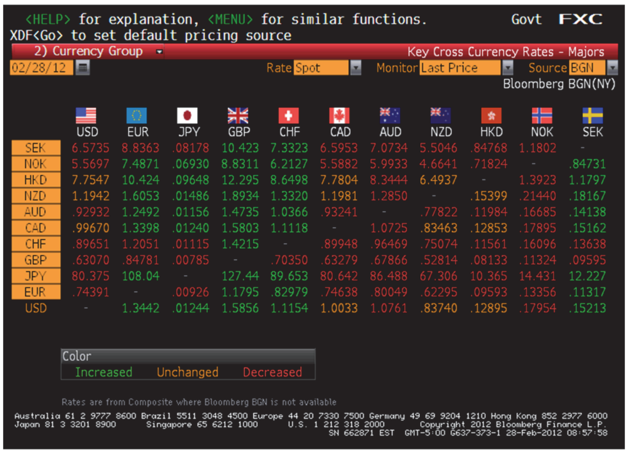
FX Cross Rates – Bloomberg Screen



<HELP> for explanation, <MENU> for similar functions. Govt FXC
XDF<Go> to set default pricing source
2) Currency Group Key Cross Currency Rates - Majors
02/28/12 Rate Spot Monitor Last Price Source BGN
Bloomberg BGN(NY)

	USD	EUR	JPY	GBP	CHF	CAD	AUD	NZD	HKD	NOK	SEK
SEK	6.5735	8.8363	.08178	10.423	7.3323	6.5953	7.0734	5.5046	.84768	1.1802	-
NOK	5.5697	7.4871	.06930	8.8311	6.2127	5.5882	5.9933	4.6641	.71824	-	.84731
HKD	7.7547	10.424	.09648	12.295	8.6498	7.7804	8.3444	6.4937	-	1.3923	1.1797
NZD	1.1942	1.6053	.01486	1.8934	1.3320	1.1981	1.2850	-	.15399	.21440	.18167
AUD	.92932	1.2492	.01156	1.4735	1.0366	.93241	-	.77822	.11984	.16685	.14138
CAD	.99670	1.3398	.01240	1.5803	1.1118	-	1.0725	.83463	.12853	.17895	.15162
CHF	.89651	1.2051	.01115	1.4215	-	.89948	.96469	.75074	.11561	.16096	.13638
GBP	.63070	.84781	.00785	-	.70350	.63279	.67866	.52814	.08133	.11324	.09595
JPY	80.375	108.04	-	127.44	89.653	80.642	86.488	67.306	10.365	14.431	12.227
EUR	.74391	-	.00926	1.1795	.82979	.74638	.80049	.62295	.09593	.13356	.11317
USD	-	1.3442	.01244	1.5856	1.1154	1.0033	1.0761	.83740	.12895	.17954	.15213

Color
Increased Unchanged Decreased

Rates are from Composite where Bloomberg BGN is not available
Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2012 Bloomberg Finance L.P.
SN 662871 EST GMT-5:00 G637-373-1 28-Feb-2012 08:57:58

On this table, the base currency is on horizontal axis.

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Foreign Exchange Cross Rates

GBP/NOK → Find common pairs: GBP/USD And USD/NOK → GBP/NOK = GBP/USD X USD/NOK

Commodity Markets

A commodity is a basic good often used to produce other goods.
It is essentially uniform and therefore interchangeable with other commodities of the same type.

Soft Commodities (usually grown)	**Hard Commodities (usually mined)**
Coffee	Crude Oil
Sugar	Rubber
Corn	Gold
Cotton	Silver
Soybeans	Natural Gas
Pork bellies	Other metals
Live cattle	

Major Commodity Markets

Major Commodity Exchanges

CME and CBOT
cattle, hogs, milk, cheese, butter, lumber

NYMEX and COMEX
coal, crude oil, natural gas, copper, gold

US Regional Exchanges
Memphis (Cotton), NADEX (energy), Minneapolis (Grain)

International Exchanges
London Metal Exchange, ICE, MCX

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Commodity Markets - Spot

The spot price is the current price of a spot contract at which a particular commodity can be bought or sold for immediate delivery and payment at a specified place

Each commodity has a standard size contract. For example, a gold contract is 100 oz. A soybean contract is 5,000 bushels.

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Commodity Markets - Futures

A commodity futures contract is a contract to buy or sell | a pre-arranged amount of a certain commodity | at a specific price on a specified future date.

Most contracts settle in cash.
But a holder that doesn't sell contract, may end up having to take physical delivery if that is specified.

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Commodity Markets

Futures Price = Spot Price + Storage Costs, Risk Free Rate Time to Delivery

Futures Price = (Spot + Storage costs) x e^(risk free rate x time to delivery)

e is Euler's number or 2.718281828

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Commodity Markets

Who trades commodities?
- Producers
- Speculators

Goals
- Hedging
- Trading profits

Commodity Markets

Stock Market
- Derives its value from an underlying asset
- Fixed supply of shares

Commodity Market
- Physical product
- Limited supply


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