

# FOREX VS. FUTURES

**MarketCenter**

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The global foreign exchange market is the largest, most active market in the world. Trading in the forex markets takes place nearly round the clock with over \$1 trillion changing hands every day. It is the main event.

The benefits of forex over currency futures trading are considerable. The dissimilarities between the two instruments range from philosophical realities such as the history of each, their target audience, and their relevance in the modern forex markets, to more tangible issues such as transactions fees, margin requirements, access to liquidity, ease of use and the technical and educational support offered by providers of each service. These differences are outlined below:

- **More Volume = Better Liquidity.** Daily currency futures volume on the CME is just 1% of the volume seen every day in the forex markets. Incomparable liquidity is one of many advantages that forex markets hold over currency futures. Truth be told, this is old news. Any currency professional can tell you that cash has been king since the dawn of the modern currency markets in the early 1970's. The real news is that individual traders from every risk profile now have full access to the opportunities available in the forex markets.
- **Forex markets offer tighter bid to offer spreads than currency futures markets.** By inverting the futures price to compare it to cash, you can readily see that in the USD/CHF example above, inverting the futures dealing price of .5894 - .5897 results in a cash price of 1.6958 - 1.6966, 8 pips vs. the 5-pip spread available in the cash markets.
- **Forex markets offer higher leverage and lower margin rates than those found in currency futures trading.** When trading currency futures, traders have one margin rate for "day" trades and another for "overnight" positions. These margin rates can vary depending on transaction size. FOREX.com currency trading gives the customer one rate all the time, day and night.
- **Forex markets utilize easily understood and universally used terms and price quotes.** Currency futures quotes are inversions of the cash price. For example, if the cash price for USD/CHF is 1.7100/1.7105, the futures equivalent is .5894/ .5897; a methodology followed only in the confines of futures trading.

Currency futures prices have the added complication of including a forward forex component that takes into account a time factor, interest rates and the interest differentials between various currencies. The forex markets require no such adjustments, mathematical manipulation or consideration for the interest rate component of futures contracts.

- **Forex trades executed through FOREX.com are commission free.** Currency futures have the added baggage of trading commissions, exchange

fees and clearing fees. These fees can add up quickly and seriously eat into a trader's profits.

In contrast, currency futures are a small part of a much larger market; one that has undergone historical changes over the last decade.

- Currency futures contracts (called IMM contracts or international monetary market futures) were created at the Chicago Mercantile Exchange in 1972.
- These contracts were created for the market professionals, who at that time, accounted for 99% of the volume generated in the currency markets.
- While some intrepid individuals did speculate in currency futures, highly trained specialists dominated the pits.
- Rather than becoming a hub for global currency transactions, currency futures became more of a sideshow (relative to the cash markets) for hedgers and arbitragers on the prowl for small, momentary anomalies between cash and futures currency prices.
- In what appears to be a permanent rather than cyclical change, fewer and fewer of these arbitrage windows are opening these days. And, when they do, they are immediately slammed shut by a swarm of professional dealers.

These changes have significantly reduced the number of currency futures professionals, closed the window further on forex vs. futures arbitrage opportunities and so far, have paved the way to more orderly markets. And while a more level playing field is poison to the P&L of a currency futures trader, it's been the pathway out of the maze for individuals trading in the forex markets.