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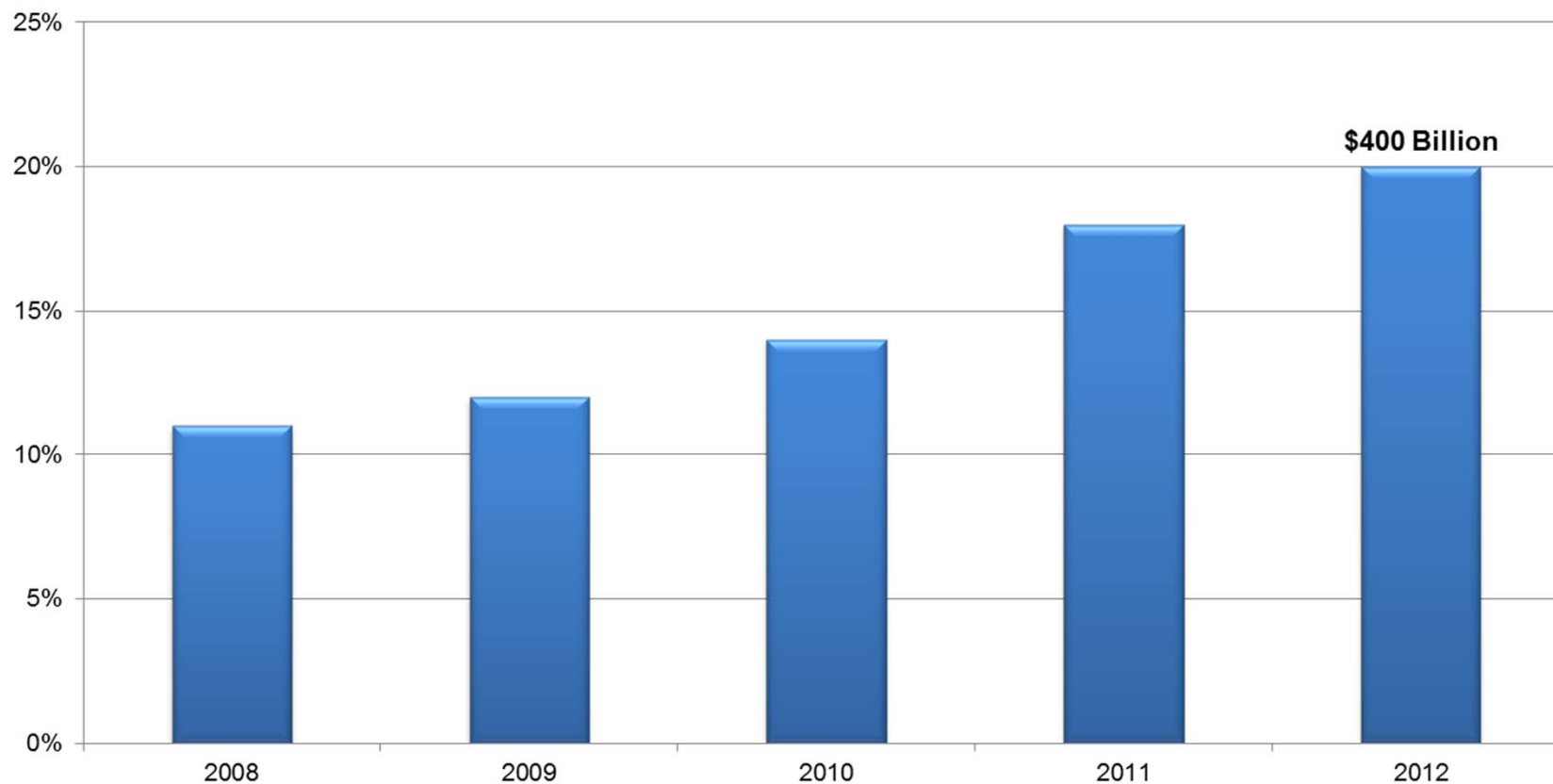
State of the Retail Foreign Exchange Market

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Retail volume growth

Upward trending growth

Average daily retail volume as a percent of total Spot FX



Who is the retail FX trader?

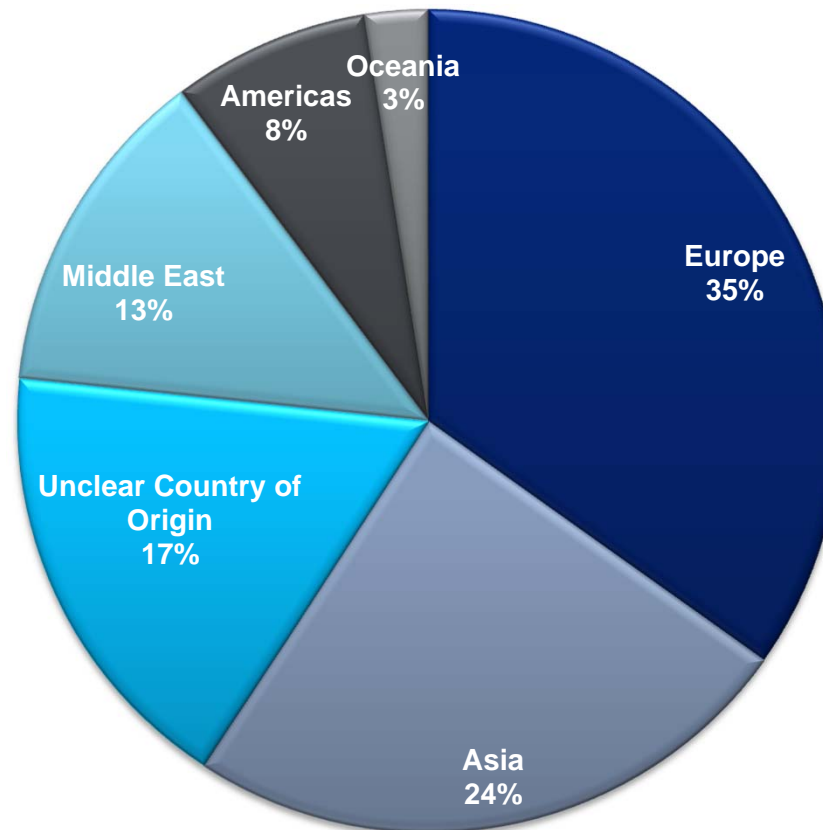
Demographics

- Predominantly male
- Median age of 35
- There are **4 million** traders spread around the globe
- In the USA, they have an average of \$6,600 on deposit
- 1.4 million live in Europe
- 1.6 million live in Asia
- Only 150,000 live in the USA



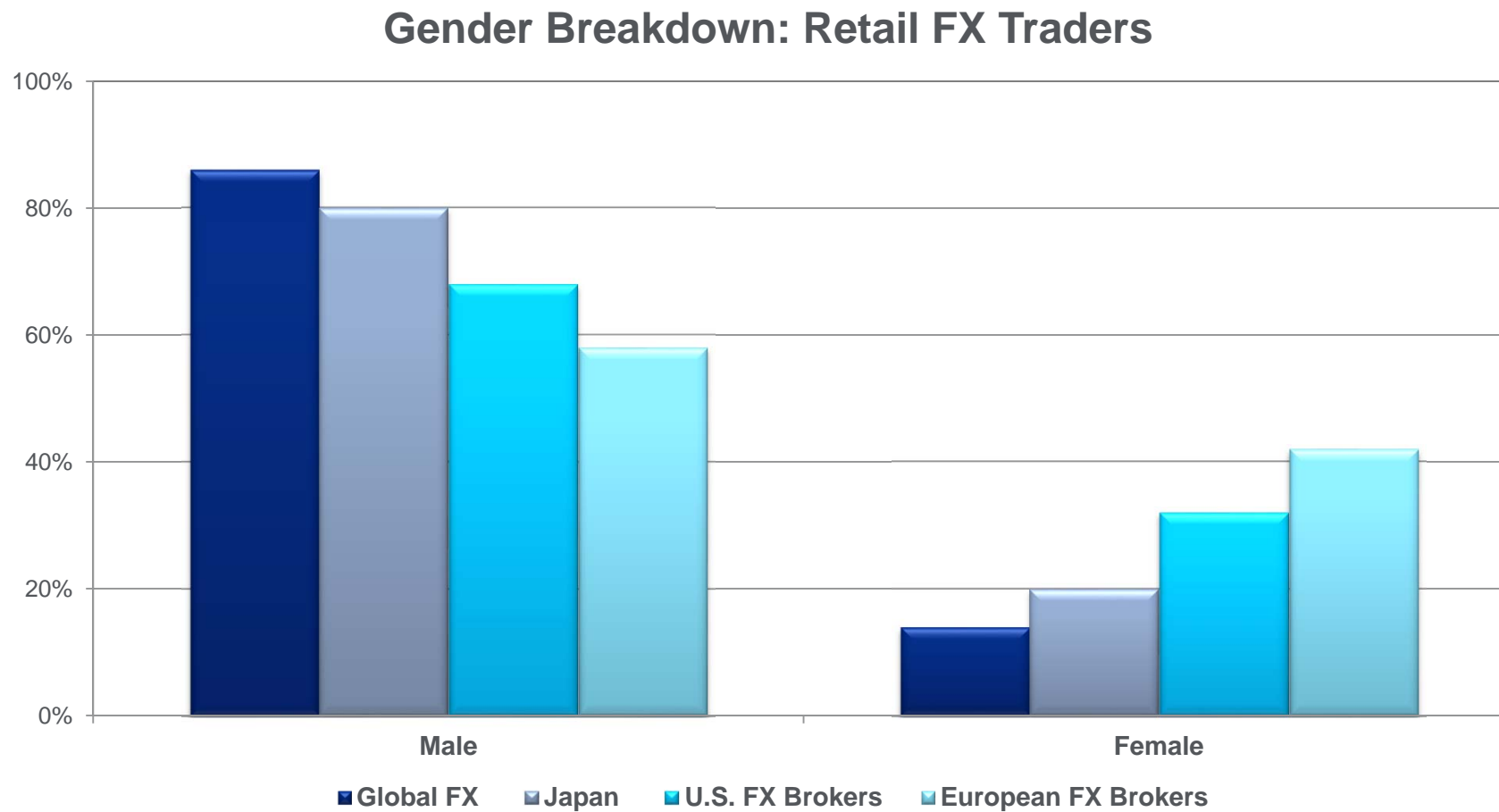
Where do they come from?

Geographic Location of FX Online Visitors to Broker Websites



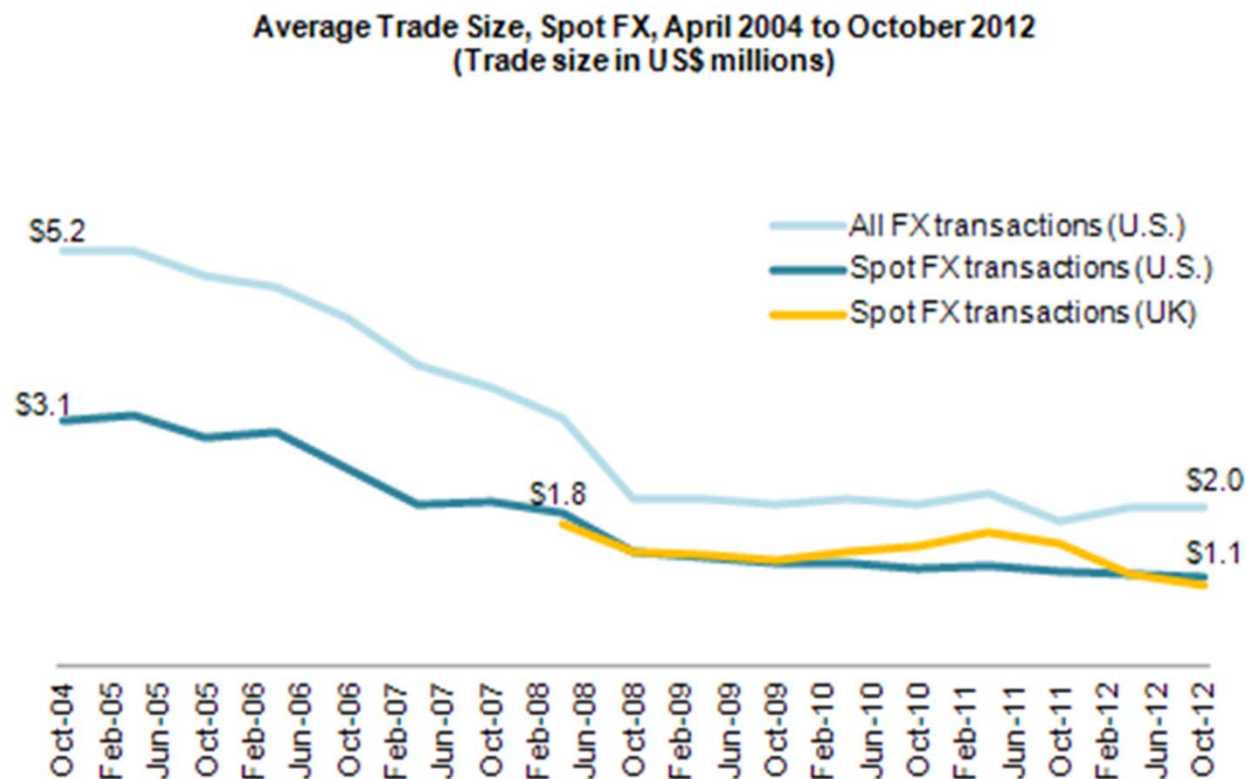
In Europe, they tend to be women

Gender Breakdown: Retail FX Traders



Small trades have reduced average trade sizes

Average Trade Size, Spot FX, April 2004 to October 2012 (US\$ Millions)



the US equity market evolved in the same way

US Average shares per trade, 1997 to 2009

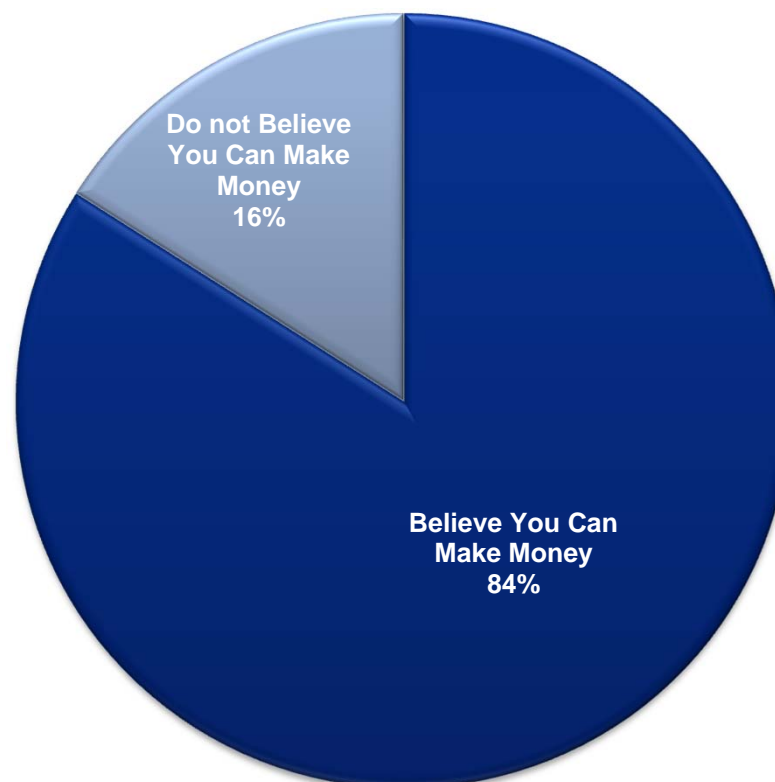
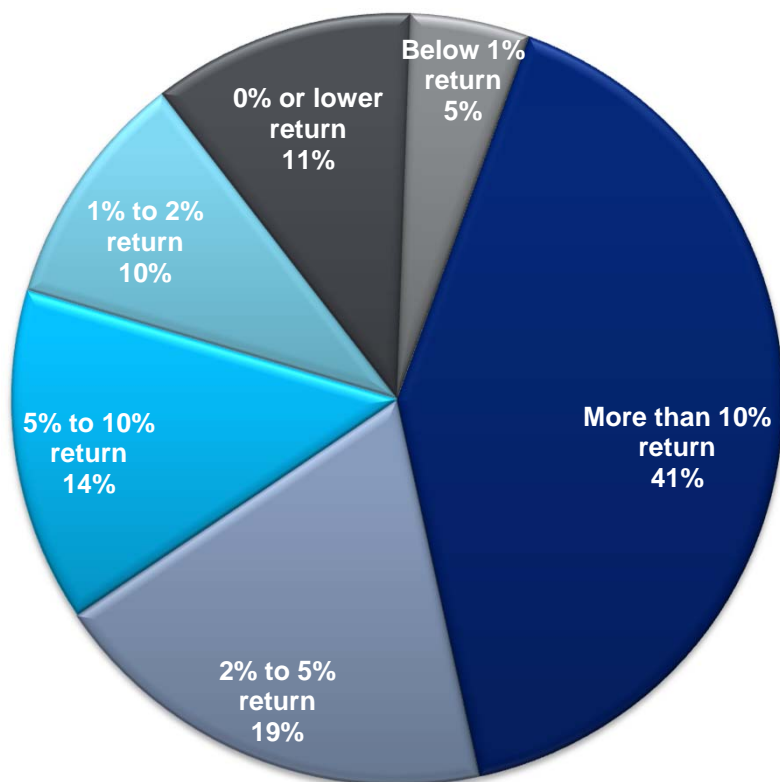
US Average shares per trade



Perception

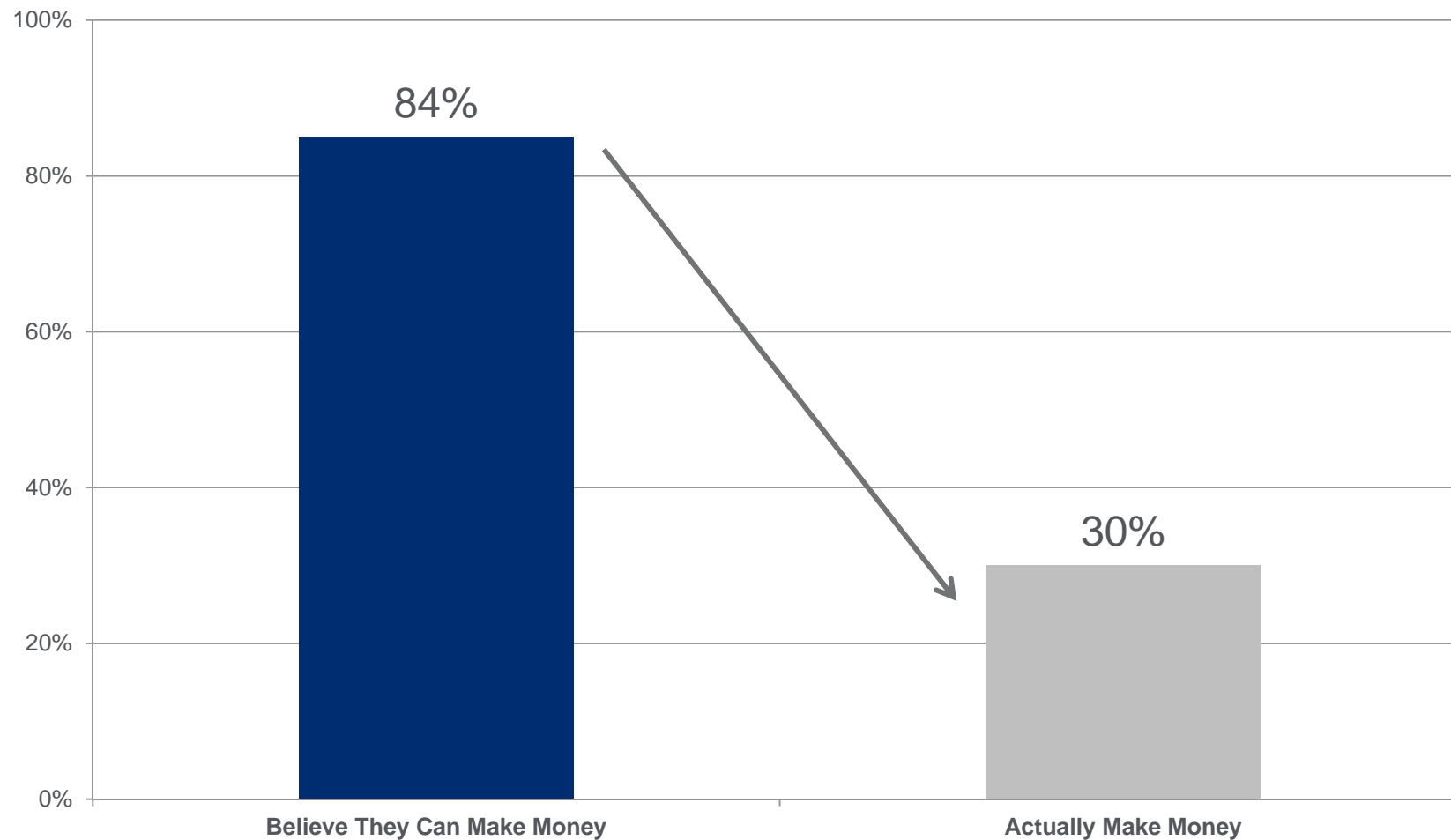
Poll of current and potential retail FX traders shows:
84% believe they can achieve positive monthly returns

84% believe they can achieve positive monthly returns



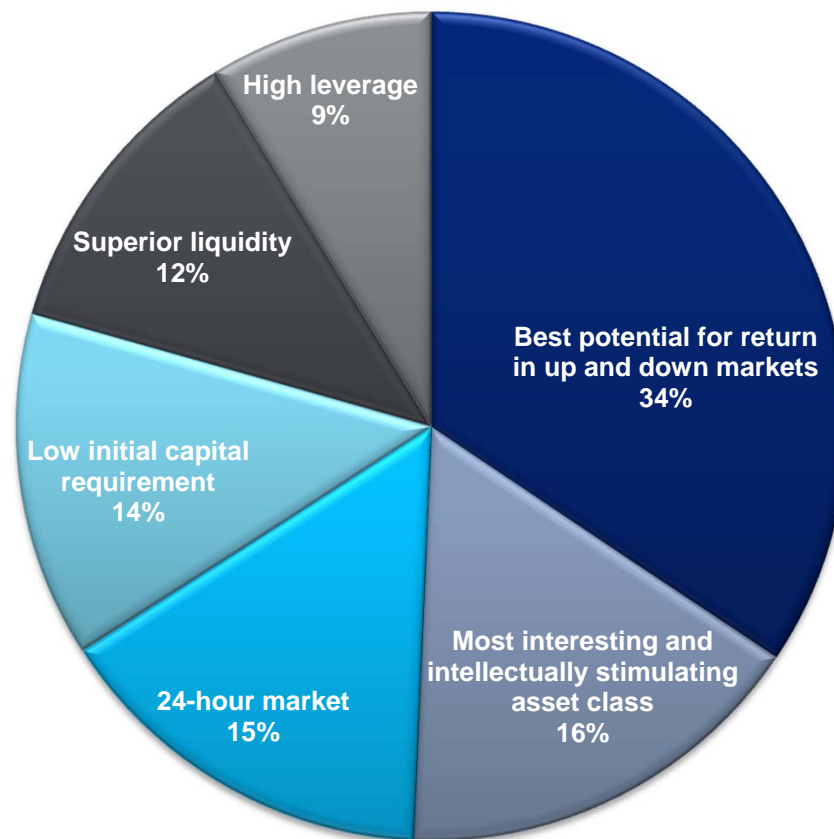
Reality

Only 30% of current and potential retail FX traders can actually achieve positive monthly returns



Reasons for choosing FX

Liquidity is not the main driver



Reasons for choosing FX

Multitude of reasons

- Leverage
 - Between 1 to **1000** times the initial margin deposit
- Low initial capital requirement
 - As low as \$50
 - Many will also accept credit card payments
- Superior liquidity
 - Prices from disparate liquidity pools can create a spread that is close to 0, or even negative in some cases
 - Brokers employ aggregation technology to bring multiple liquidity sources to their clients
 - Many retail brokers actually aggregate liquidity from smaller brokers, and thus become a broker of a broker
 - But not all spread narrowing is always available to end-users
- Platform choices are plentiful
 - While there are many platforms for the retail trader to choose from, MetaTrader4, or MT4 as it is better known, has become the standard
 - This platform allows the retail trader to purchase pre-built strategies or write their own
 - These pre-built strategies are called Expert Advisers
 - Some of these Expert Adviser strategies develop a large following, thus pushing many small trades into the market at once

Leverage

A Double-Edged Sword

Leverage across countries

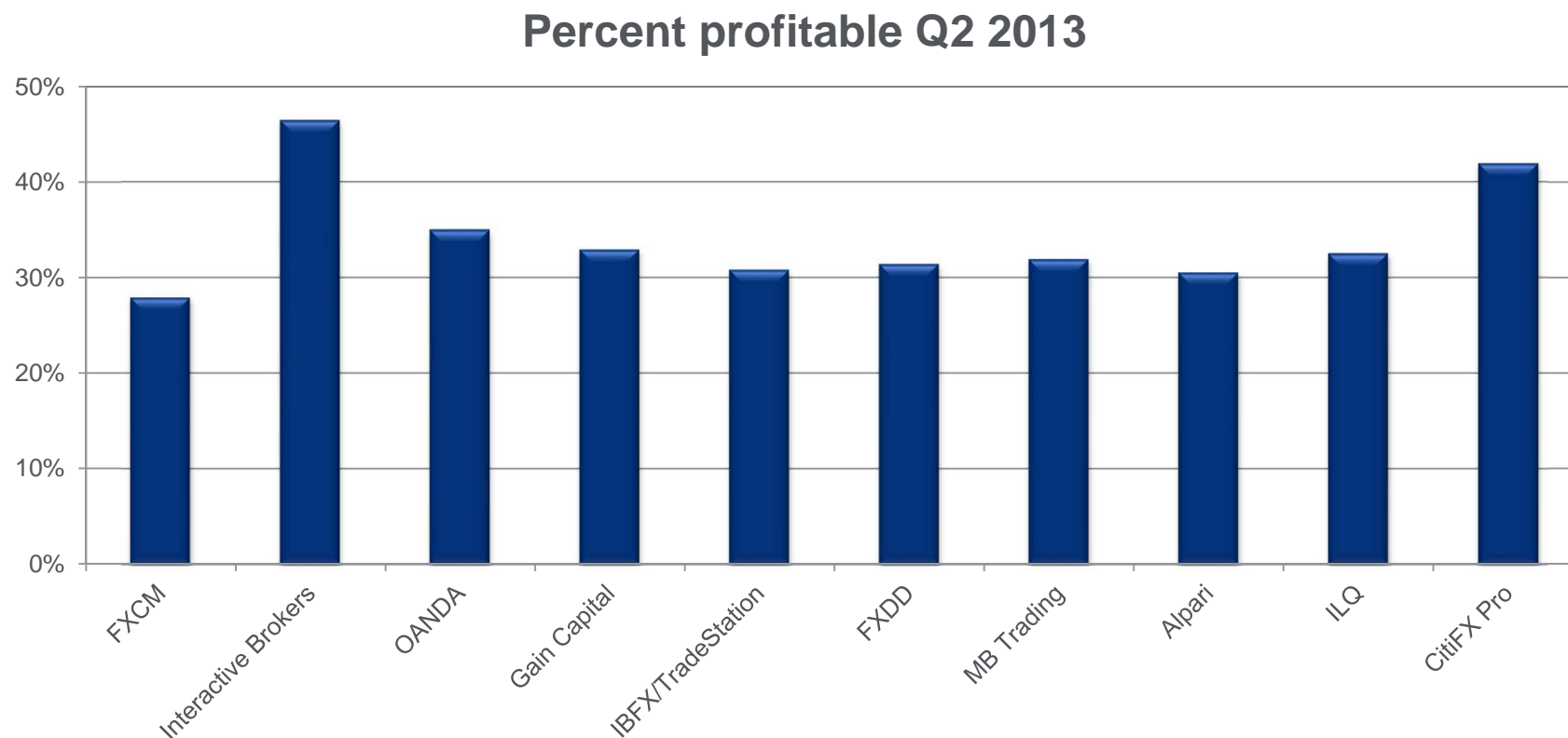
Country	Leverage
Europe	200:1 (Typical, can be higher)
United Kingdom	200:1 (Typical, can be higher)
USA	50:1
Japan	25:1
Hong Kong	20:1 (for most currencies)



- Most countries have or are discussing putting limitations on leverage
- Some brokers advertise leverage of 1000:1
- While high leverage seems attractive at first, it can be harmful
- If a trader has a small account, say \$1000 and uses his 200:1 leverage
 - Trader purchases \$200,000 EUR/USD
 - A move of just 50 pips (exclusive of spread) will bring his account to \$0

Profitability of US clients

Percent profitable Q2 2013



- Note that both Interactive Brokers and CitiFX Pro have higher minimum account deposit requirements of \$10,000

Account size vs. profitability

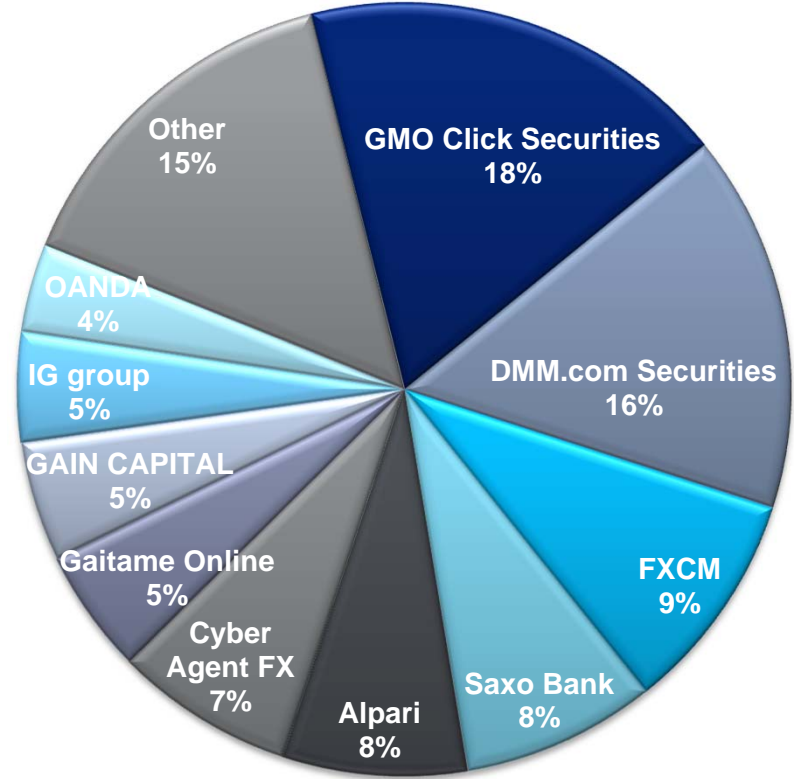
Larger accounts tend to be more profitable

- In a 2011 interview Drew Niv, CEO of FXCM, stated, “Profitability is skewed downward by the many micro accounts of the company. These micro accounts, which can be opened for as little as \$50, are less profitable than averaged-sized accounts because the traders take their accounts less seriously and tend to “go for the moon.”
- Conversely, FXCM accounts larger than \$10,000 have profitability that are double the average. Part of it is likely due to the natural selection of profitable averaged-sized accounts surviving and becoming large accounts.”
- In recent conversations with a large Japanese broker, they noticed a trend of very high net worth clients entering the market.
 - These clients tend to hold trades for a longer time period than smaller accounts, usually 2-3 hours, versus 3-5 seconds
 - Trade larger sizes of \$3-5 million
 - More profitable than smaller accounts, this broker tends to hedge 80% of these clients trades, versus 30% for smaller accounts



Broker preferences - global

Market Share



Retail broker characteristics

- **85% of worldwide retail FX volume is traded through just 10 brokers**
- **These 10 brokers enjoy certain privileges:**
 - Strong negotiating stance with the large liquidity providing banks in regards to spreads and depth of liquidity
 - Ability to control which platforms become successful
 - Economies of scale in marketing
- **There are two primary business models**
 - Principal
 - The broker takes the other side of the clients trade
 - Assumes risk and offers a service to the client by creating liquidity
 - Betting against the client
 - Agency
 - The broker is effectively guaranteed a profit on each trade, as they pass the risk along to a liquidity provider
 - The broker takes no market risk

Retail broker characteristics

Principal and agency

- **Both Principal and Agency models share the same technology risks**
 - Losing track of inventory
 - Has no idea of current positions
 - Has risk of blowing out if a large move occurs
 - Losing connectivity to market place
 - Cannot hedge or exit positions
 - Losing connectivity to clients
 - Clients can lose money from not being able to enter or exit positions
 - Broker could be held responsible for losses
- **Prime Brokerage**
 - Majority of retail brokers must have a prime brokerage relationship in place with a bank in order to conduct business
 - A prime brokerage relationship allows for the retail broker to trade against a number of counterparties, while only having a margining and credit relationship with 1 or a few banks
 - As a prime broker, the bank also provides operational support to the retail broker, ensuring that trades are confirmed and settle properly
 - In turn, due to the dependence of the retail broker on the prime broker, the net open position limit determines how fast the broker can grow their business

Regulations - the good and bad

Advantages and disadvantages

- **Advantages for the retail trader**


- Safer environment
- Deposits are safer
 - Many FX traders fear their broker will simply close up shop and steal their deposits
- Encourages growth due to stability

- **Disadvantages for the retail trader**

- Less competition amongst brokers
- Which fosters wider spreads
- Reduced investment in technology due to less need to innovate to retain clients
 - Leads to less functional trading platforms
- Increased barriers to entry for the small guy
- Increased minimum account size
- Reduced leverage

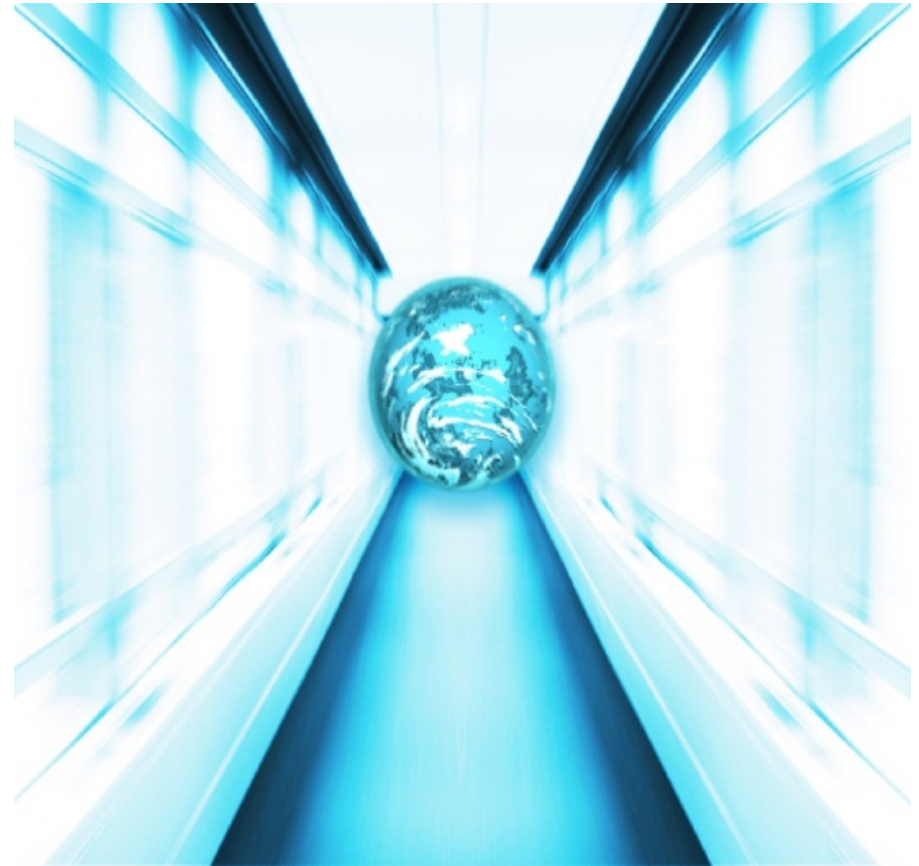
Regulations - the good and bad

Turkish and US experiences

- In September 2011, **Turkey** passed a law prohibiting non-licensed currency brokerages from handling retail trades
 - The initial response was a loss of volume
 - Regulators say that since September of 2011, average daily volumes have more than tripled
 - Turkey is currently trading more than \$1 billion a day in retail FX
 - Proves the positive impact regulation can have
 - This is a win-win for everyone
- 
- The **US** passed regulations requiring all US brokers to have a minimum on deposit of at least \$20 million
 - This shrunk the market of brokers dramatically
 - Only a few survive
 - Notable names are: CitiFX Pro, FXCM and Gain

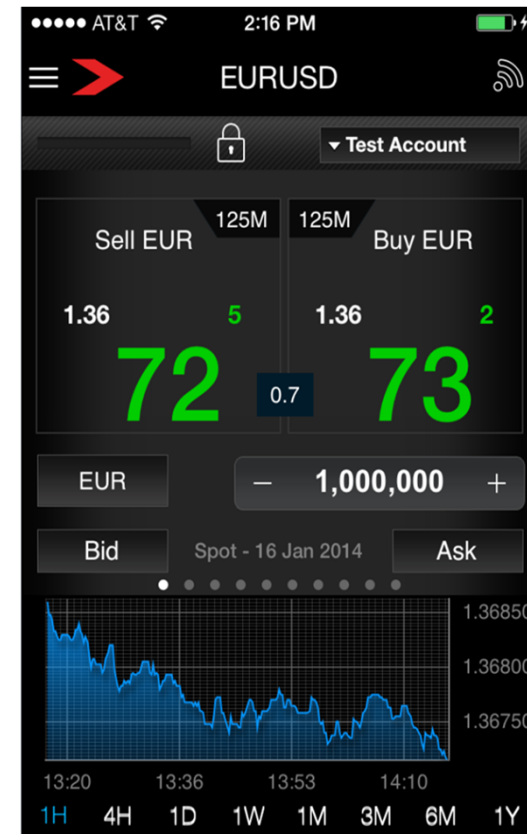
FX brokers travel the globe in search of less regulation

- Historically, brokers have been attracted to the domiciles with the least amount of regulations.
- Hot beds of broker activity would spring up in a certain country
- Once a few large names went to that country, the rest would follow
- The USA was a large destination till the NFA started passing stringent laws and collateral requirements of \$20 million
- Cyprus was also a large destination till the financial crisis hit them
 - This was very popular since it gave the brokers access to the Eurozone
- New Zealand is the latest hotspot, but they are starting to pass regulations as well.



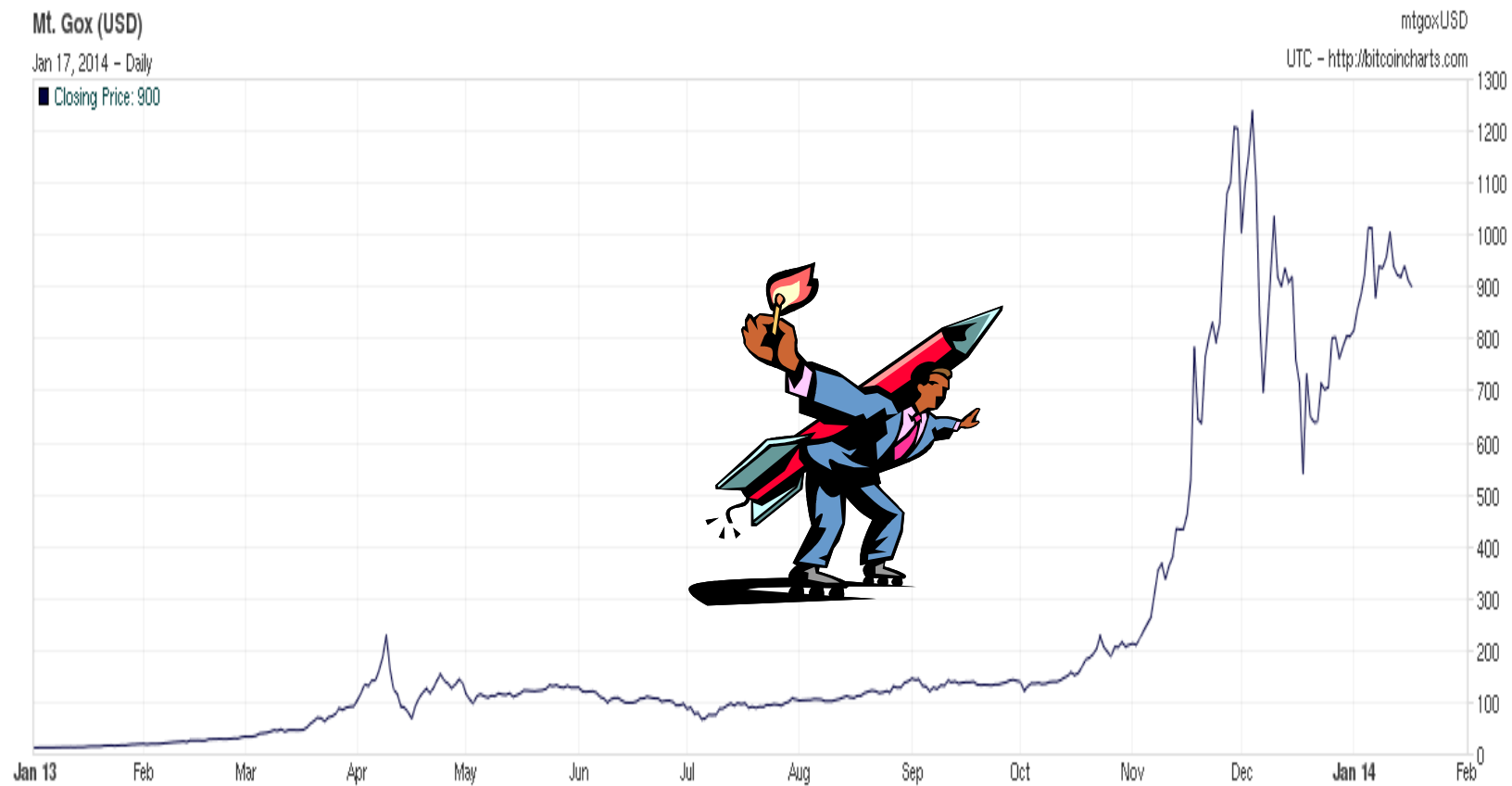
Trends

- Mobile trading
- BitCoin & crypto currencies
- Social trading / Mirror trading
- Binary options
- Metals
- Retail brokers pursuing institutional business
 - FXCM Pro, Gain GTX, FXDD (Frontier)



BitCoin / crypto currencies

Ready to Fly, or Just a Fad?



Bitcoin / crypto currencies

Ready to Fly, or Just a Fad?

- **Rise in value of Bitcoin has been astronomical**
 - From \$13 one year ago to over \$1200 last month and \$900 today(1/17/14)
- **What attracts people to Bitcoin?**
 - Lack of trust in central banks, governments and printed currencies
 - Anonymity
 - Off the grid/untraceable
- **Downside of Bitcoin**
 - No insurance if hacked
 - Accounts and Bitcoin “banks” appear to be vulnerable, as several have already been hacked.
 - Attractive for money laundering and tax evasion
 - Extremely volatile, not suitable for practical exchange currency

Social trading / mirror trading

- **Everyone becomes a fund manager.**
 - No registration, oversight, or regulation required
- **Pick a trader to follow**
 - Follow their trades automatically.
 - The leader or trade picker receives a portion of the profits of his followers
 - Some also have commission sharing split with broker



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efficiency, renewable energy and mitigation

