

Forex Minis Shrink Risk Exposure

by Selwyn Gishen

Trading currencies means buying one country's currency while simultaneously selling another country's currency. Every currency trade therefore involves two currencies. The usual size of a currency pair is 100,000 units, known as a "standard lot".

In most cases, beginner traders do not want to stomach the risk that comes with the exposure of a standard lot. As a result, most online forex brokers offer the ability to trade mini lots, which are 10,000 units of the currency rather than 100,000. For a new trader, these mini lots can be an especially effective tool for learning to trade forex. (For background reading, see [Getting Started In Forex](#).)

What is a pip?

Before one can fully understand the benefits of a mini lot, it is important to review the concept of a pip. A pip is the smallest increment that a currency pair can move. For most currency pairs, a pip is a change in the fourth decimal place of the currency quote. For example, if EUR/USD is quoted at 1.5567 and it moves to 1.5568, it has increased by 1 pip. The value of 1 pip is calculated by the size of the lot that is traded. So, if you buy a standard lot of 100,000 EUR/USD at 1.5567 and it goes to 1.5568, a 1-pip move, then the value of your trade has increased by \$10 (or $100,000 \times 0.0001$). (For more on this, see [What is the value of one pip and why are they different between currency pairs?](#))

If we did the exact same calculation using a mini lot, then we would multiply the 1 pip by the size of a 10,000 mini lot instead of the usual 100,000 lot. So $10,000 \times 0.0001 = \$1$. When you trade a standard lot, the value of the pip is \$10 but when trading a mini lot the value of a pip is \$1. This is true when the U.S. dollar is the second, or quoted, currency in the pair. (For more, see [Common Questions About Currency Trading](#).)

Base Currency Vs. Quote Currency

One other piece of information to remember is that a currency pair is comprised of a base currency, which is the first currency listed in the pair, and the quote currency, which is the second currency listed in the pair. In the case of the EUR/USD, the euro is the base currency and the dollar is the quote currency.

The profit or loss is always expressed in terms of the quote currency. If the currency pair is the GBP/USD, then the base currency is the British pound and the quote currency is the U.S. dollar. For the USD/CAD, the base currency is the U.S. dollar and the quote currency is the Canadian dollar. Why the dollar is listed first in some instances but second in others is just a matter of convention. (For more insight, see the [Forex Tutorial: Reading a Quote and Understanding The Jargon.](#))

The Value of a Pip

The last important point that should be noted before we talk about mini lots specifically is the value of a pip. Suppose you are trading the GBP/JPY; the British pound is the base currency and the Japanese yen is the quote currency. Now in this instance, we have an exception to the fourth decimal place rule for the size of a pip. In the case of the yen, 1 pip is measured in the second decimal place. The yen is the only exception. To calculate the value of the move, if we buy dollars against the yen and the dollar goes up from 103.45 to 103.46, then we have a 1-pip move. Multiplying by the standard lot of $100,000 \times 0.01 = 1,000$ yen. To bring this back to dollars, you would then divide the 1,000 yen by the dollar rate, let's say it's 103.46, which equals \$9.66.

Why Trade Minis?

The real value of trading minis is in the versatility it provides in matching the trade size to an acceptable level of risk. For example, suppose you decide to take a long position in the USD/JPY. Let's assume that your entry point is 103.55 and that you've set your stop-loss order 15 pips away at 103.40. If you have \$1,000 in your trading account, the maximum risk you should take in any trade is 3% of your trading capital. Because your capital is \$1,000, 3% of your capital is \$30. If you are stopped out of this trade and you are trading a mini lot, you will lose \$15. But if you are prepared to risk \$30, you can actually trade two mini lots and get the power and benefit of some leverage. If you were only trading standard lots, this trade would not be possible because a 15-pip loss, as per this example, would be \$150, which is 15% of your \$1,000 trading capital. Given a risk tolerance of 3% of the portfolio, this is too much risk for one trade. (For related reading, see [Forex Leverage: A Double-Edged Sword.](#))

Mini lots allow a trader to adjust the amount of effective leverage used in each trade. With mini contracts, you can trade the equivalent of one standard lot by simply trading 10 minis. If you only want to trade a half of a standard lot, you can do so by buying five mini lots.

Conclusion

Mini lots provide flexibility that standard lots cannot offer. A mini lot is simply 10% of a standard lot and therefore, by trading in minis you can trade in fractions of a standard lot, anywhere from 1 mini to 10 minis. Mini lots are useful if the natural stop loss for your trade is farther away than the maximum risk you feel comfortable taking. You can simply reduce the risk by decreasing the number

of minis until that number would equate to the stop-loss risk. Of course, if your market maker offers you 100:1 leverage, then for an account of \$1,000, you can trade up to 10 minis at a time. The number of minis traded should be governed by how much you can lose if your trade goes wrong, which should not exceed 2-3% per trade.

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