THE INTERNATIONAL JOURNAL OF BUSINESS & MANAGEMENT

Study of Foreign Exchange Technical Analysis

Simanta Das
Assistant Professor, Asian Institute of Management and Technology, Guwahati, Assam, India

Abstract:
Lean principle is widely used in manufacturing industries and it has wide spread benefits. However way lean is implemented depends on various factors. Many companies are being increasingly conscious of the fact that accounting and traditional costing methods have direct effect on their lean implementation initiatives. It is therefore imperative that proper cost and accounting methods are devised and adopted for lean initiatives in an organization. Role of various accounting system needs to be studied.

1. Introduction

Forex (foreign exchange market) is the world's largest financial market. It is a market where one country's currency is exchanged to another currency. The exchange rates of currencies are permanently changing due to alterations in the supply and demand of the country's products. Different players in the market are trying to earn money with exchange rate fluctuations by buying Currency at low price and selling it at higher price or vice versa. Today, forex is an online market, which makes it easy for anyone to participate. Compared to other financial markets there are different advantages that make forex very popular. The average daily turnover in Forex in 2008 was estimated to be more than three trillion U.S. dollars. In comparison, The New York Stock Exchange lists 30 billion daily turnover.

In any financial market, an investor can use either technical analysis or fundamental analysis (or both) for forecasting future price movements. Technical analysis monitors the price movements in a chart with different indicators. Fundamental analysis analyses common economic situations using different financial statements, such as news and reports.

2. The Scope of the Study

The study is a project-based and creates a strategy for forex trading that uses technical analysis (predicting the price movements according to price movements in the exchange rate chart) as a method of forecasting exchange rate movements. The outcome of the study is an ebook containing a trading strategy. Fundamental analysis (predicting price movements according to economical factors) is taken into account in the study, but it is not studied further in detail. Emotional factors that also affect trading decisions, were not included in the study.

3. Finding Theory, Studying Forex and Technical Analysis

In this stage, the meaning was to study forex market and technical analysis carefully. Theory was collected from books, articles and online forums. This theory was then applied to the trading strategy. The books about forex are the main source for the study. Four books were chosen to be primary sources for making the trading strategy. There are numerous books available about forex and many of them deal with fundamental side of currency trading. The books had to be chosen very carefully, as they author wanted specific books that are concentrated on the technical side of forex. In addition, it was very important to find books that supported the author's idea of creating a strategy that would be simple to use.

Forex Made Easy: 6 Ways to Trade the Dollar by James Dicks (2004) was chosen as it provides a lot of information about forex market as a whole. It also gives ideas of trading techniques in forex. The second book that was chosen to be another main source was *Profiting With Forex:*

The Most Effective Tools and Techniques for Trading Currencies, by John Jagerson & S. Wade Hansen (2006). This book is a very comprehensive book about trading techniques and it provides a lot of information about different options a trader can use as ways of trading. *Forex Trading Using Intermarket Analysis*, by Louis B. Mendelshon (2006) was chosen due to its concentration on forex trading using technical analysis. This book provides a lot of information about simple tools for technical analysis that a trader can use in forex. The last book that was chosen was an overall guide to technical analysis. This book was made for the stock market, but the same rules of technical analysis apply in the stock market as in forex. The last book was *Chart Your Way to Profits*, by Tim Knight (2007). These four books, in addition to several online sites that were used as secondary sources, covered all the aspects to cover in theoretical part.

4. Definitions of Key Concepts

The key concepts are forex (foreign exchange market), currency trading, technical analysis, market patterns, trading strategy and intra-day trading. All the chart figures used in

5. Foreign Exchange Market (Forex)

Forex is the largest financial market in the world. It is an online market, where currency pairs are being traded 24 hours a day, five days a week. Daily turnover in 2008 was more than $3 trillion. Typical transaction involves buying one currency and selling another with free-floating exchange rates. The biggest players in foreign exchange market are different banks, corporations and governments, but also millions of individual currency traders take part in trading. Forex is a two-way market, where a trader can either enter a buy position or a sell position. When one trader is making a profitable trade in forex, it means that another trader is losing.

6. Currency Trading

Forex is the place to trade currencies. Players in the market use large quantities of currency to make profit as the value of currency changes. Currency fluctuations take place because of two things:

- The real market
  Investors or visitors need some currency to buy goods from another country, and they have to convert their own currency to another currency and the other way around. As a need for currency grows, its value goes up.
- Speculation
  Investors try to figure out how currency will react to a certain incident, such as economic news, e.g. interest rate releases.

Individual traders trade through their online brokers. For example, when taking a buy (long) position in EUR/USD currency pair, a trader will simultaneously buy euros and sell dollars. If the trader has analyzed correctly, he will make profit if the value of euro strengthens against dollar. If the euro weakens against dollar, the trader will lose money. If the exchange rate in EUR/USD would be 1.3000 before the trader entered his long position, and when closing the trade the same exchange rate grew to 1.3001, he would have gained one pip from his trade. Pip (price interest point) is the last decimal of a price, and it is a system to determine profit or loss in forex. The pip values and position size determine the profit/loss in dollars

7. Technical Analysis

Technical analysis is a way of predicting future price movements. It is one of the oldest tools used in financial markets. Technical analysis analyses indicators, market patterns and it is based on the idea that history repeats itself and the price moves in trends and patterns. For technical analyst it is important to know how other players in the market see future movements.

8. Trading Strategy

Trading strategy is very important for every trader involved in forex. Trading strategy contains very specific entry rules that need to be fulfilled before a trader can enter a position. Money management is the most important thing in a trading strategy, as it is the basis for continuous profit making. Without proper money management a trader will most likely fail and lose money.

9. Intra-Day Trading:

Intra-day trading simply means that a trader opens and closes a position he has taken during the same day. An intra-day trader does not take positions that last longer time periods, e.g. days, weeks or even months. Intra-day traders trade using shorter timeframe price charts (1min-4h). Depending on the trading platform used, a trader can get exchange rate timeframes from 1 minute to 1 month.

10. Motives to Trade Forex

Forex trading volumes have been growing rapidly in recent years as participants like banks, financial institutions, hedge funds, multinational corporations and individual traders create different strategies to benefit from currency fluctuations and minimize the risks. According to Mendelsohn (2006, 14-15), there are three main motives to get involved in the forex market.

The first motive is “to convert profit in foreign currencies into a domestic currency to bring gains back “home”. This is something that international companies do on a daily basis. The second motive is “to hedge exposure to risk from changes in forex values”. Companies use this way of minimizing the risk in their international deals. They want to lock in profit with forex position instead of taking a risk if currency values change. The third and the biggest motive is “to speculate on changes in currency values”. It is impossible to indicate how big the volume of speculation is, but it is estimated to be about 95 % of all forex activity. (Mendelsohn 2006, 14-15.)

According to Mendelsohn (2006, 14-15) there are three different venues that are involved in forex trading:

- The biggest share of forex trading takes place in the interbank market. This market is a “global over-the-counter” network and it consists of world’s largest banks and other large financial institutions and corporations. Interbank market has no centralized marketplace. Transactions are done between parties over phone or electronically. Deals may involve billions of dollars, which explains why these players are called “big boys” in forex.
- Cash forex trading has been one of the fastest going segments in the past few years. Individuals and corporations are gaining information about online trading and less restrictive regulations. Controversy frauds have become also more common as fake brokers enter the market. This is why a trader needs to pay a special attention to a company background, when choosing a broker for trading.

- Forex futures have been a common trading method for about thirty years. Chicago Mercantile Exchange (CME) introduced futures for currencies already in May 1972. In recent years forex futures have gained popularity. In 2004 CME traded over 50 million forex contracts, which was a 50 % increase from 2003. Advantages of forex futures are the centralized market, tight bid/ask spreads, transparent pricing and the fact that there is no counter-party risk, as the traders trade only with one firm.

11. Forex Market vs. Stock Market

In the stock market, each time a trader decides to buy or sell shares he will have to pay a commission. Often an investor will contact a broker, who will make the required action for him. In forex one does not have to pay any commission. (Jagerson & Hansen 2007, 10-14.) The U.S. stock market is open from 9.30 am to 4 pm from Monday to Friday. Often market investors are working during these days. Forex is open 24 hours per day, five days a week, which means that a trader can enter a position anytime he wants. The orders will be filled in seconds. The forex market has much more liquidity than any other financial market. (Jagerson & Hansen 2007, 10-14.)

Bearish (down-trending) markets are usually something the stock investors do not like. Selling (shorting) a stock has a much more complex meaning that it does in shorting a currency. It is also much more risky and expensive due to its many stages. In forex, if an investor thinks that some currency will lose value, he just clicks on "sell" and will gain profit, should this happen. (Jagerson & Hansen 2007, 10-14.)

In the stock market an investor can find a huge selection of shares. This might be confusing, as an investor should be aware of every company's economic situation. Usually every investor diversifies interesting stocks into his portfolio. By doing this he will also lose chances of benefiting from shares outside his portfolio. In forex it is probably enough for a trader to keep an eye on the major currency pairs. (Jagerson & Hansen 2007, 10-14.)

The stock market is even more trending market (and predominantly an up-trending market), so it might be easier to make profit during long up-trends than it is in forex. During an uptrend, an investor can invest money and trust that the market will continue going up. In forex changes occur more often. (Jagerson & Hansen 2007, 10-14.)

12. Technical analysis

Technical Analysis is one of the older tools used for trading in any financial market. It has been used for at about 30 years and there are as many versions of technical analysis as there are traders. People take advantage of technical analysis in many different ways. "The common description of technical analysis is that you take past performance of a position, equity, currency, future, or whatever and tie it together with mathematical calculations to try to predict the future outcome of the position". (Dicks 2004, 32.)

13. What Is It and Why It Works?

The study of past price movement for forecasting future price movement is called technical analysis. Like any trading method it can lead to profit if done correctly. The study of technical analysis is based on three facts:

The price chart gives all the information needed of the balance of buyers and sellers

- Prices move in trends and patterns, which can lead to statistically meaningful probabilities in future movements
- History repeats itself, hence skilled examination of exchange rate chart will guide a trader to give entry and exit signals Technical analysis relies on the fact that price charts will always give the most correct picture of a tradable object. "Chart is as good as it gets".

When buyers are more powerful than sellers (there are more buyers than sellers), the price of a currency will go up. If sellers are more powerful than buyers the price moves down (there are more sellers then buyers). Speculation between these two groups leads to the movements that take place in the market on a daily basis. This is the basic idea that technical analysts try to predict from exchange-rate charts. If an individual trader would always know whether there are more buyers than sellers he would be multimillionaire. (Knight 2007, 2.)

Studying the forex market and creating a strategy based on the learned issues was a challenging but a very interesting task. The overall process of making this study was very interesting and rewarding. It was very important to do something concrete, from which other forex traders could benefit some day.

14. References

1. Babypips.com School. Pattern Schmatterns. URL: http://www.babypips.com/school/pattern_schmatterns.html. Quoted: 27.05.2009.
2. Chen, J. 2007. Technical Analysis of STOCKS & COMMODITIES magazine. Technical Analysis Inc. Support and Resistance Precision in Forex. URL: www.traders.com/reprints/pdf_reprints.html$fx_forex. Quoted: 25.05.2009.
3. Dicks, J. 2004. Forex Made Easy: 6 Ways to Trade the Dollar. The McGraw-Hill Companies. Columbus.
4. Goforex.net. Pip Value Calculator. URL: http://www.goforex.net/pip-calculator.htm. Quoted: 27.05.2009.
5. Jagerson, J., Hansen, S. 2006. Profiting With Forex: The Most Effective Tools and Techniques for Trading Currencies. The McGraw-Hill Companies. Columbus.
6. Janssen, C., Langager, C., Murphy, C. Technical Analysis: Chart Patterns. URL: http://www.investopedia.com/university/technical/techanalysis8.asp. Quoted: 25.05.2009.
7. Jeff Boyd Authors & Publishers Inc. 2006-2009. Forex Fundamental Analysis. Basics. URL: http://www.forex-fundamental-analysis.com. Quoted: 20.05.2009.

8. Knight, T. 2007. Chart Your Way to Profits. John Wiley & Sons Inc. New Jersey. Mendelshon, L. 2006. Forex Trading Using Intermarket Analysis. Market Technologies. LLC. Columbus.
9. Online Forex Course. Lesson 4. 4.2 Supply and Demand. URL: http://www.cmsfx.com/en/forex-education/online-forex-course/chapter-2-fundamentalfactors/exchange-rates-supply-and-demand/supply-and-demand. Quoted: 20.05.2009.