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The Creation of the Convenient Investment Strategy in Forex

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Abstract

Forex that belongs into the biggest and the most widespread financial markets in the world has the daily turnover that is assessed to more than 5 trillion USD. This fact is at the same time a temptation for investors and attracts them to trade in this market. Only the small percentage from this daily turnover is made of the business of governments and companies, that purchase in foreign countries or need to exchange foreign currency for the domestic one. The majority consists of the speculative business. Speculative business is based on the expectations of a speculator on the future rise or fall of exchange rate, that he plans to earn money on. In this case, we are talking about the market with unpredictable environment. It is controlled by the crowd of people who create the most extensive financial market of the world by their mutual purchasing and selling foreign currencies. The aim of this paper is to create the convenient investment strategy on the basis of the analysis of foreign exchange market. We have used the description for the fulfillment of this aim and consequently we have focused on business strategies as the fundamental and technical analysis and its use in the real trading. We have described the development of trading in the chosen market and period by means of fictitious account on the platform Metatrader4. Consequently, we have analysed the influence of the particular factors on the results of investing in Forex

Keywords: Forex, currency pair, currency graphs, investment strategy, analysis

Introduction

Theoretical background

Recently, the Forex market has been unavailable for individual investors and only big banks have been trading in this market. With the development of technical appliances and communication technologies it has been made available everywhere, where there is the internet connection. Because of this fact there is a possibility to join for smaller

“players”, too. Nowadays, foreign exchange market is the biggest and the most liquid financial market in the world. For this market, the international name Forex is used, that is the abbreviation for Foreign Exchange Market, i.e., the foreign currencies market.(Hrvoľová) Forex enables all participants to purchase and sell currency all around the world. It has gained the popularity thanks to the small number of barriers that stand in the way to this financial market to small investors. Despite the fact that the history of Forex extends to 70s of the last century, this market is the biggest and the most liquid market from all financial markets. It is traded by means of the Internet through brokers, banks and other tradesmen. According to BIS, there are trades performed daily in the Forex in the amount up to 5,067 trillion dollars (BIS), that one of the main reasons why is this market so interesting among tradesmen. It is possible to trade in thousands, but also in billions of dollars, that gives the chance to join also to smaller tradesmen.

Exchange rates do not stay on the same value, they change every day. This constant movement of exchange rates enables to earn money when trading. The aim of trading is to change one currency for another one with the expectation that the one that we purchase will raise in the value while the one that we sell will decrease in the value. Trading in Forex brings the possibility to earn a lot of money, however, more than a half of the beginning forex tradesmen loses their money mainly because of underestimating the preparation and the lack of experience. Trading in this market is a very risky business and therefore it is important before entering this market to find out the most information about it.

Advantages of Forex

It is for everyone – it is possible to start also with the little capital;

It is flexible – it is possible to trade all around the world, 24 hours, 5 days a week;

It is highly liquid – big amount of participants of market and big volume of financial resources;

Profit potential – the possibility of earnings not only when the exchange rate of currency is rising, but also when it is falling;

The leverage effect – the possibility to do the big business also with the low capital;

Free demo account – the most brokers enable opening of demo account where tradesman can try the particular strategies before he starts to trade with the real money;

Diversification – it enables to investors to use the alternative to investments in the stock exchange market;

It is decentralized – Forex does not have Central bank;

Low fees – it is mostly paid just for the spread. However, some brokers charge fines also for a transaction;

Disadvantages of Forex:

The leverage effect – it is advantage and also disadvantage, because with the possibility to earn a lot of money there is a big risk here and tradesman can lose everything;

Big volatility – changes in the market are very fast;

The problem in the choice of broker – it is very important to be careful when choosing a broker, it is better to choose the well-known and tried by tradesmen broker;

Human factor – human psychic plays a very big role in trading with the real money. The majority of the successful tradesmen agrees that the most difficult part of their career was to manage psychology of trade;

Forex is the biggest stock exchange market in the world, where 5 up to 7 million participants perform their transactions and trade every day from various reasons. The advantage of this market is its low regulation, that means that it is available for anyone. Commercial banks, central banks, investment companies, brokers, individual investors and speculators belong among the main participants of this market.

We place these currencies among the main currencies traded in Forex: american dollar, euro, japanese yen, british sterling and swiss frank. The currencies which are traded with but they do not have such a high liquidity are called additional. There belongs: canadian dollar, australian dollar, new zealand dollar and others. Exotic currencies are the currencies that are not liquid very much because of the little interest, what leads to highest costs in its trading. The most popular currencies, its symbols and slang expressions are shown in the table 1.

Table 1 The most popular currencies, its symbols and slang expressions

Symbol	STATE	CURRENCY	Slang EXPRESSIONS
USD	United States of America	American dollar	Buck
EUR	Members of Eurozone	Euro	Euro
JPY	Japan	Japanese yen	Yen
GBP	The Great Britain	British sterling	Cable
CHF	Switzerland	Swiss frank	Swissy
CAD	Canada	Canadian dollar	Loonie
AUD	Australia	Australian dollar	Aussie
NZD	New Zealand	New Zealand dollar	Kiwi

Source: Own processing

Methodology

The aim of this paper is to analyze the financial market Forex and the use of the knowledge to create the profit strategy in the speculative trading in this market. The task is to try particular trading strategies and to evaluate starting capital in the created fictitious account. To reach this aim, we have focused on the analysis of the exchange market Forex, consequently to describe the strategies of the analysis of the development of prices of currency that are the fundamental and technical analysis and its usage in the real trading. As in the applied example, we will describe 3 trades realized by means of fictitious account, in which we will use the knowledge from the analysis of exchange market that include basic information, types, forms and possibilities of trading in Forex, expressions like currency pair, pip, lot, spread etc.

We have created demo account by means of the mobile application Metatrader4. This application has provided us the direct access to the market by means of the account created directly in it. It has also been possible by means of this application the graphic display of the chosen realized trades. We have used fundamental and technical analysis in trading. These analyses are the two most used types of analysis in the Forex market, without which no tradesmen can exist and the trading would be rather a hazard than an investment.

Fundamental analysis observes economic, political and social development of particular countries that has the direct impact on the development of exchange rate. The aim of this analysis is to assess the future movement of currency pair on the basis of the new economic and financial reports. Technical analysis focuses on the analysis of graphs and the usage of various technical indicators. It is based on the concept that the history repeats, graphic patterns are created and we can predict future movements of market on its basis.

Results

Fundamental analysis

We observe the development of the Forex market by means of economic and political factors in fundamental analysis. It is important for the speculator mainly the fact, what influence the newly reported news will have on the development of the currency value. However, it is important to realize that news do not influence the market, but people do, with their reactions to news. Fundamental analysis is used by tradesmen mainly for determination of a long-term development of market. Short-term development of exchange rate depends rather on the mood of tradesmen in the given moment. However, this does not mean that fundamental analysis does not have any importance to short-term trading. The most important thing is to know, when the market moves. Tradesman who does not specialize in fundamental aspects should keep away from market in the period of news publishing. The times of announcements of the most important economic statistics are (stated times are compatible with our time zone): (Vobořil, 2011)

USA 14:30 and 16:00

Europe 10:00

Great Britain 10:30 and 13:00

Switzerland 8:15 and 10:30

Australia 1:30 and 4:30

Canada 12:00, 13:30 and 15:00

Japan 0:50 and 12:30

Every month, many new economic news appear, from which the majority does not have the revelant effect and it does not move with the currency value. Primarily, those news are important for tradesmen that have the immediate and outstanding impact on its development. The most important indicators influencing particular currencies are (Vobořil, 2011):

Interest Rates

Announcements: 8 times annually, various data, always in the evening, usually at 20:15

NonFarm Payroll – Unemployment

Announcements: every first friday in the month at 14:30

GDP

Announcements: every month, mostly in the fourth week in the month at 14:30

Core CPI

Announcements: every month at 14:30

Retail sales

Announcements: every month, in the middle of month, at 14:30

Economic calendar serves as the survey on economic statistics. It is possible to display events in current day or week. The calendar shows events that were already announced but also the ones that are being planned to be announced, what brings tradesmen the time for preparation. Economic statistics can be interpreted in the short time trading in two ways:

In the first way we investigate, if the currently announced value has positive or negative influence on the development of the particular economy in the future. We compare if the current value is in comparison with the previous one rather optimistic or pesimistic. According to this, we adopt a standpoint for the next development of currency rate of the particular currency pair.

The second, simpler way is the comparison of the expected value with the current announced value. If the change between these two values is too big, we can expect the strong movement to some direction.

Technical analysis

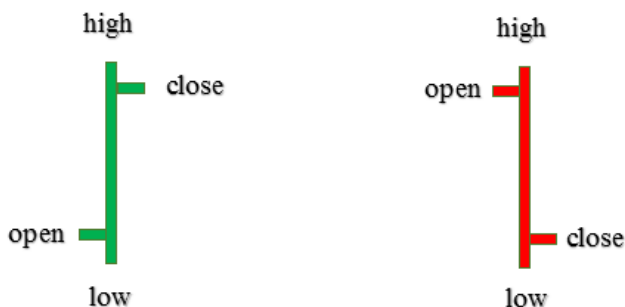
In the short-time and medium-term period mainly tradesmen and their current mood that often changes, influence the development of exchange rate. Conscious or unconscious fear from the reached results brings about instability and outstanding price movements on the exchange market. Currency rate graphs are the tool which helps to understand these movements and to work efficiently with them.

Technical analysis observes the behaviour of these graphs. It belongs among the most used tools for trading not only in forex market but also in others financial markets. Concerning market generally, nothing is guaranteed, not only in the case of technical analysis where there is not a system that would guarantee a definite success. It only helps to assess what will happen with prices.

Short-term tradesmen work mostly with the five-minute or one-hour graph, while the tradesmen who analyze price movements in the long-term period, use month graphs. Tradesmen analyze these movements on graphs to create business strategies and to make various business decisions.

Linear graph belongs into the simplest exchange graphs depicting movement of prices. It connects final prices in the given period. It is very clear but it shows only the direction which the market follows, not what happens there.

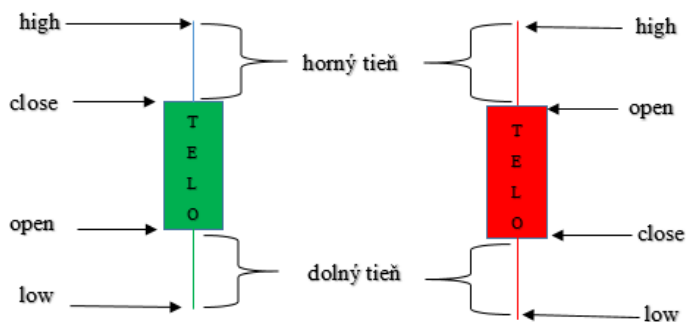
Bar graph has much bigger predicative value than linear graph. Graphs display lines that carry 4 important information regarding the price of currency value. The peak of every line represents the maximum price (HIGH) reached in the given period and on the other hand, the bottom represents the lowest (LOW). Processes on the sides determine opening price (OPEN) and closing price (CLOSE), that currency rates are traded under at the beginning and at the end of the given time period.



Picture 1: Bars[] Source: Own processing

In the case when buyers are stronger than sellers, the line is in green colour. If the line is red, sellers dominate over buyers.

Candle graph depicts the same information regarding the highest, the lowest open and close price than linear graph. The graph consists of candles put together from the body and shadows. The difference between open and low price is created by low shadow. Upper shadow is the difference between high and close. The body represents the activity between close and open price. The longer is the body of the candle, the more intensive is the purchasing or selling pressure.(Hartman, 2009)



Picture 2 Candles [] Source: Own processing

The candles are distinguished by colours as it is in bar graphs. Colour difference in bar and candle graphs provides more information and faster orientation. The appearance of these graphs provides more detailed insight to the psychology of market participants, thanks to which it is applied mainly in short-term trading.

In technical analysis, there are many different technical indicators. It concerns different mathematical calculations that help to predict the future development of the rate. They are already built in every trading platform so they do not need to be counted. The basic groups are:

Trend indicators that follow market trend. Its role is to recognize, follow and eventually determine the end of trend

The most used are:

- Moving averages
- Running averages konvergences/divergences (MACD)
- Parabolic SAR
- Average Directional Index (ADX)

Oscillators, which comes out of cyclical repetition of movements have the role to measure the strength of market. They show, when is the market prepared for turn.

The most used are:

- Stochastic Oscillator
- Commodity Channel Index (CCI)
- Momentum
- Relative Strength Index (RSI)
- Williams's Percent Range (%R)
- Indicators of volatility measure market volatility. The higher the volatility is, the bigger volume of money we can get.
- The most used are:
 - Bollingers bands (BB)
 - Rate of Change (RoC)
 - Average True range (ATR)
- Volume indicators measure the activity of participants, strength and intensity of market.
 - The most used are:
 - Money Flow Index (MFI)
 - On Balance Volume (OBV)

Demo account Trade no. 1

On 15 minute graph EUR/USD we observed creating, symmetrical triangle. The price of currency pair was oscillating up and down. We drew in two oblique lines connecting increasing and decreasing high prices. As it is never clear what direction will the price finally go, we observed carefully the graph. When the price got over the bottom line we entered into short position. In the time of entrance into the trade, the price of currency pair was 1,23150. We realized the sale in the value of 10 lots. We set up the stop-loss to the value of 1,23290 in case there would be a false signal. We set up the take-profit to the value of 1,23090, what was the approximate distance of the height of the triangle. The price formation really went up and the price started to plunge. The trade closed immediately when the set up take-profit was reached. The profit from the trade was 600 USD.

Picture 2 Trade no. 1



EURUSD, sell 10.00 2018.03.16 15:10:52
1.23150 → 1.23090 **600.00**

Source: Own processing in Metatrader 4

Trade no.2.

We observed the creating price graph head and arms after the strong uptrend on 15 minute graph GBP/USD. We drew in the level neckline by connecting the lowest prices. We also drew in the target distance, where could the price go after getting over that level. When the price got over the neckline, we entered the short position. We have set stop-loss over neckline in the value of 1,40350. We have set take-profit somewhere in the middle of the target price in the value of 1,39750. The ratio of the risk loss and potential risk was approximately 1:5. The formation was not succesful and the price began to rise gradually till it got to the level of the set up slop-loss. The loss from the trade was 535 USD. The loss from swap was 9,30 USD from the reason of keeping the position at night. The total loss was then 544,30 USD.

Picture 3 Trade no. 3



Source: Own processing in Metatrader 4

Trade no.3

We identified the levels of support and resistance on 15 minute graph EUR/USD. We made together 4 trades. In the first trade we entered the long position after repelling the price from support. In the case of getting over some level, we always set up stop-loss, to evade big losses. The price repelled and rose. The trade was concluded by set up take-profit with the profit 235 USD. After the certain time, the price began to decrease till it got to the level of support again. After repelling, we entered to the second trade. The profit was 275 USD. The price rose till it got to the level of

resistance. We entered the short position. However, the price was still rising till it got over the border of resistance. The price got to the level of the set stop-loss where the trade was concluded with the loss 230 USD. The mistake was the bad setting of the order stop-loss, which was set immediately over the level of resistance. As the price later bounced back from the border of resistance several times, we also entered to the next short position. Finally, the price decreased to set take-profit. The profit was 310 USD. The total profit from 4 trades was 590 USD.

Picture 5 Trade no. 4



Source: Own processing in Metatrader 4

Conclusion

In the course of research period we concluded together 10 trades, from which 7 were profitable and 3 made loss. The total profit went up to the value of 3 409,54 USD and so we managed to appreciate the starting capital by 3,4%. We tried different strategies

and if we wanted to continue in trading, we would focus rather on deciding on the basis of information from the technical analysis. We regard it as more reliable as it is based on facts and not on assumptions, that can be initiated by subjectivity of investor and non-objectivism of information. Trading in Forex is the great way how to use redundant financial resources in the high degree of positive relation of investor to risk. Thanks to the flexibility and almost continuous running, Forex enables to dedicate to investing whenever, what is convenient for investors in today's impatient times. It is characteristic by the huge volume of trades and practically unrestricted liquidity. One of another big advantage is the possibility of using financial resources not only when currency rate grows but also when its value decreases. However, it is necessary to realize that the trading here is not easy mainly for the beginning investors. As many as 95% of beginning tradesmen lose their investments on this market. This type of investment includes mainly psychological burden, regardless of timeframe, considering the fact that beginner opens his first real commercial account after the period at least 3 to 6 months of the intensive study of this financial market, its behavior and the use of demo account. More trades, more positions, more currency pairs or indices will gradually drive investor into bigger and current minus or into faster losses. Losses bring frustration that causes the impression of necessity to get the money back as soon as possible, which, at the same time pushes investor to trades that he would not conclude in considerate position. To be successful investor in Forex means at first to lose financial resources and consequently to use the possibility to join the group of investors who earn money in this risk market. Also in our case of demo account, we had profit trades as well as loss trades when using different strategies and where the balance of strategies and considerate decisions finally brought the positive result of the use of investment. The capital accessibility of this market as well as the leverage and high liquidity are the combination of factors that can bring the both effects of investing in considerate investment. Only the certain type of investor and the right strategy can influence the result.

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