“YOU CAN MAKE A KILLING IF YOU GUESS RIGHT. That’s the allure. A $5,000 trade to buy the euro and simultaneously sell the dollar, entered the afternoon of July 10 and leveraged 100 to 1, had soared to $12,850 just 24 hours later, after the euro rose nearly two U.S. cents on the news that mortgage giants Fannie Mae and Freddie Mac were teetering on the brink.

AND IF YOU GET IT WRONG? You can lose all your money.” (Kosnett, 2008)

The above vignette gives a gist about scope of profit making in currency trading using technical analysis which though not an easy task conjecturally speaking isn’t even one which cannot be mastered with thorough knowledge and discipline. Also a lot depends on the financial behavior of a particular participant (Hilton, 2001).

Mastery is required as the risk involved is considerably high. (Bredin et al., 2004)

“The sample studied (1990–1998) represents a period where the foreign exchange rate risk represented an important part risk. This research represents the first part of a comprehensive study which will analyse the risks faced by firms/banks in the Irish market. The study focuses on the foreign exchange market, which was certainly faced with a high degree of volatility over the early part of the study period.”

The preferred risk-reward ratio differs individual to individual and is highly influenced by the personality traits and risk perception of an investor as explained by (Chitra et al., 2011) be it any security – Currency, Commodity, Equity etc.

**The Foreign Exchange Market**

The Foreign Exchange market stands alone as the largest and most liquid markets in the world with trillions being traded daily. Open 24 hours a day, five days a week, this asset class is available to everyone from national banks and international corporations to the individual day trader.

The market tops $4 trillion in average daily turnover (McFarlin, 2010). He also points out that trading in Foreign Exchange means exchanging one currency in return of another either to hedge impending risk due to exposure in a specific currency or to profit from exchange rate movements.
The currency can be traded either in the Spot Market, Forwards/Futures market, ETF’s or Options Market. It was found that recently the spot market dominates price discovery (Rosenberg, 2009). Till date, many traders mostly trade certain currencies vs. the U.S. dollar only. That restricts the trades to dollar fundamentals, sometimes at the expense of the fundamentals of the other side of the trade. Traders can even expand their opportunities by trading cross pairs where in US Dollar has been used as a vehicle currency (Chelkowski, 2010).

Glen Arnold et al. in the book Corporate Financial Management have highlighted that in the Foreign Exchange market most of the trades are between banks for speculation rather than for underlying export or import. The results of the study done by (Ramcharran, 2000) signify this as it shows a strong relationship between the trading income of banks and exchange rate volatility.

But those trades that are done against genuine exposure can affect the following entities:
1. Receipts for Export
2. Payment of Imports
3. Valuation of foreign assets and liabilities
4. Long-term viability of overseas operations
5. Feasibility of a foreign project

Additionally, even if one does not trade in Foreign Exchange Market directly, the value of any currency in terms of another can sometimes affect the market you watch more than any other variable (Murphy, 2004). Believers of random-walk theory say that investors can't beat the stock market because news travels too rapidly. When a new bit of information emerges, investors react to it almost instantly, bidding a stock's price up or down until it reaches a new equilibrium. Therefore, the only things that the market hasn't taken into account are things that haven't happened yet. Those events are, by definition, random. Thus in other words, they believe that any amount reasoning cannot help in predicting the market (Coy, 1999).
But those who do reason they do it either fundamentally or technically. These are the ones who believe that an informationally efficient market reflects relevant information fully and promptly (Liu, 2007).

And some do it really well, Investigation of an index of returns on professionally managed currency funds showed that over the 1990-2006 period, currency fund managers earned excess returns averaging 25 bps per month using 4 distinct styles of currency trading - carry, trend, value, and volatility. The study also inferred that Trend strategies have celebrated an unexpected revival (Levich et al., 2008).

**Forecasting Markets - Fundamental Factors versus Technical Indicators**

Fundamental analysis is a method of evaluating securities by attempting to measure the intrinsic value of a stock. Fundamental analysts study everything from the overall economy and industry conditions to the financial condition and management of companies.

On the other hand, Technical analysis is the evaluation of securities/assets by means of studying statistics generated by market activity, such as past prices and volume. Technical analysts do not attempt to measure a security's intrinsic value but instead use charts to identify patterns and trends that may suggest what the security will do in the future. (Venkatesh et al., 2011) and (Talati, 2002)

One type of technical Analysis - Elliott Wave Theory claims that the movement of the stock market could be predicted by observing and identifying a repetitive pattern of waves thus helping the trader and investor to reduce risk and maximize profit (Dharmaraj et al, 2011). Same are the uses of any other type of technical analysis tool. In other words, Technical analysis focuses exclusively on the study of market action while fundamental analysis focuses on the underlying economic forces of supply and demand that cause prices to move up or down or stay the same.

In accepting the premise of technical analysis, one can see why technicians believe their approach is superior to the fundamentalists. If the fundamentals are reflected in market price, then the study of those fundamentals becomes unnecessary (Murphy, 1999).
Technical Analysis
Technical analysis is a constantly evolving emerging science because quantitative methods for evaluating price movement to make trading decisions have now become a dominant part of current market analysis.
Detecting new trends early using mechanical trading rules in technical analysis is one of the techniques that professional traders use to make abnormal returns above the benchmark return of the passive buy-and-hold policy (Azizan et al., 2010).

Rationale of Technical Approach of Forecasting
Most technical chartists concur that much of what we call Technical Analysis today has its origins in theories first proposed by Dow around the turn of the century. Dow Theory still forms the cornerstone of the study of technical analysis, even in the face of today’s sophisticated computer technology, and the proliferation of newer and supposedly better technical indicators (John Murphy, 1999).
(Krishnan et al., 2009) very clearly indicate that technical analysis is profitable in currency trading in foreign exchange spot market, which is proven by the fact that all the four currency pairs, six time frames and ten indicators under consideration yielded trading profits in foreign spot market.
(Bettman et al., 2009) state that, “Testing confirm the complementary nature of fundamental and technical analysis by showing that, although each performs well in isolation, models integrating both have superior explanatory power.”
In another paper (Caginalp et al., 1998) evidence is provided that traders are influenced by price behavior in short term.
The results of the study conducted by (Okunev et al., 2003) indicates that the potential exists for investors to generate excess returns in foreign exchange markets by adopting a momentum strategy using the moving average rules identified in this paper. It is not at all apparent that foreign exchange markets operate in an efficient manner and that returns are determined entirely by fundamental information. In fact, very simple technical rules can generate quite significant returns beyond those that can be explained by transactions costs or risk.
(Venkatesh et al., 2011) inferred that at shorter horizons there exists a skew towards reliance on Technical Analysis, while the skewness moves towards fundamental analysis for long term Investments.
Trend strategies applied to currencies show the best results over medium-term rebalancing cycles of 3–6 months (Mettler et al., 2010).
(Middleton, 2005) also cites that trend trading remains a dominant style of managing currencies. People still keep on raising doubts about the trending of the currency market and whether charts can be used to forecast future movements. The profitability of technical currency trading has been declining since the late 1980s (Schulmeister, 2008). There is evidence that there are lower returns from trend-trading than before, but the recent trading profits for exotic currencies are still attractive (Pukthuanthong et al., 2007).

**Japanese Candlestick as a Technical Analysis Tool:**

(Steve Nison, 2001) in his book on Japanese candlestick techniques mentions that Japanese Candlestick technique is a versatile tool that can be fused with any other technical tool, and will help improve any technician's market analysis. Some researchers (Northcott, 2009) provide a warning that candlesticks should never be used alone to make a trading decision. They don’t show enough about the rest of the price activity, and their interpretation often depends on the trend they are in. One should determine the overall market position using conventional technical indicators before entering into a trade. Candlesticks work best at indicating reversal points when the price is overbought or oversold, in which case they can help with the timing of your entry. In this situation, a Doji candle indicates that no one is in charge, neither bulls nor bears, so the trend is neutral. Individual candlesticks such as the hanging man and hammer formations display a wealth of information and can indicate the probability of a one-day reversal, but there is also the possibility that they could simply be outliers, so patterns made of multiple candlesticks can offer confirmation that the reversal is real (McMahon, 2007).

There are hundreds of named candlestick patterns, but many traders choose a few that seem to work best for them in the markets they trade. The successful interpretation of them all comes back to the basic ideas expressed above (Northcott, 2009). Which of these are best suited for the Indian market is what this paper intends to find out. Also, whether the Japanese Candlestick work in the Indian Currency market by itself, or do they need support of Western Technical Indicators and Fundamental factors is another aspect that will be interrogated.
Technical Analysis in Indian Context

Though the basic tenets of trading using any technical indicator should generally remain the same, it may at times vary depending upon the convertibility of a currency and maturity of the market.

For India it may depend on things like the trends in inflows of foreign capital into the country. It is also known that, Reserve Bank of India often prevents the exchange rate appreciation associated with rising capital inflows by accumulating foreign exchange reserves and foreign investments (Singh et al, 2010). Similarly, Reserve Bank of India at times also prevents depreciation. It is thus necessary to study the Candlestick Charting Techniques in Indian context and develop suitable strategies as at this point of time India is still in the transition stage to fuller openness (Chakravarty, 2011).