

## USING THE SYSTEM OF MONEY MANAGEMENT WITHIN THE EURUSD PARITY

Cornelia Elena Tureac<sup>1</sup>, B. Andronic<sup>1</sup>, Anca Gabriela Turtureanu<sup>1</sup>,  
A. C-tin Filip<sup>1</sup>, Gabriela Pădure<sup>2</sup>

<sup>1</sup>„Danubius” University, Galați

<sup>2</sup>„Dunărea de Jos” University, Galați

e-mail: cornelia\_tureac@yahoo.com

### Abstract

*In this article we want to emphasize the importance of using the system of money management within the EURUSD parity. The efficient use of a system of money management system, facilitates the long-term maximizations and in the same time and the limit of losses, independent of the degree of efficiency of transactions. The money management system being a problem of probability statistics is essential, and the efficient administration of the count in the idea of small loss in the case in which the strategy does not work it makes the difference between gain and loss. The research method consists in using literature of specialty, using the trading program XTB Metatrader v 4.0 and using the methods of controlling the transactions and of their volume through the Stop Loss and Take Profit orders within the EURUSD parity. In conclusion, the money management system is destined to keep in game the investor, despite his losses.*

**Key words:** EURUSD, system, money management, parity, transaction

### INTRODUCTION

The exchange risk is one of the many types of risk at which is exposed an enterprise. It results especially from the participation of the enterprise at the foreign trade, from making investments in nature or in capital outside the country or attracting of financings under the form of loans expense accounts in foreign currencies.[1]

The relatively high volatility that we observe during the recent years on the forex markets may be a factor with unfavorable influence on the financial results or on the company's position in relation to competition.

The decline of the export revenue, higher costs of the raw materials or imported goods or the increase of the costs generated by loans – these are the main problems that may be generated by an improper management of the currency risk. The problem of the currency risk affects more often the individuals, once with the increase of the popularity of the granted credits in foreign currencies.

The currency risk is defined as being the possibility of changing the component values

of assets, of the financial rotation or of debits, due to the changes of exchange rates.

Considering the above definition, the risk management is actually the reduction of the potential variations of value of the assets' components or of the generated debits by the expected or planned values. Such a goal can be achieved through the insurance transactions, by using derivative instruments.

The full solvency, lack of commercial addition, of hidden costs or provisions and elasticity in terms of adjusting the level of transaction and date of expense account – these are the main qualities due to which the forex contracts and the course difference become an instrument increasingly used in the speculative transactions and insurance.[3]

Many investors enter in the activity of buying/selling shares as a result of a clearly defined goal: to make money. Many of them forget that goal and over time they start to trade for the adrenaline which the market is offering and forget that their main purpose is to increase the portfolio.

There are situations in which an investor makes 10 consecutive transactions on profit and one on loss, on the overall its portfolio is

reduced; this happens because of the lack of a system to protect the portfolio, that the lack of a money management.[5]

The money management is one which should turn a certain loss in an assumed loss and of which size is controlled. Also, a money management system (and here the system must be created by each) has the role as a large number of transactions, to increase the portfolio, even if sometimes we are subject to losses. [6]

## MATERIAL AND METHOD

The material used in this article is found in using the literature of speciality. The research method used is materialized in the use of the program Metatrader v 4.0, and the use of control methods and their volume through the orders of Stop Loss and Take Profit.

## RESULTS AND DISCUSSIONS

The main purpose of managing the currency risk is the stabilization the value of the future financial rotation in foreign currencies at a rate that we know, we specify and accept it. The administration (management) of risk can be approached through the prism of two concepts:[2]

A conservative approach – related to the idea of full ensuring of a currency, so that the exchange rate changes do not result in changes in the values of the financial rotation. Thus even as today, we can determine, regardless of the changes in the exchange rate, the value – expressed in local currency – of the debts, future debts or of the credit rates.

An active approach – that a management of the currency risk which may take the form of an active management of particular currency. In this case, we consciously decide to leave a partial or total degree of exposure at risk (including full insurance) can occur when we believe that the currency reached to an advantageous course for us

The main benefits arising from the management of the currency risk:

- eliminating or limiting the influence of exchange rate changes on the profits or the costs;

- improving the planning and management conditions of solvency and additional financial costs elimination

- possibility of using the current rates, favorable of the currencies to fix the value of the future financial contributions

The risk management in the investment process is based on the idea of stabilizing the increasing dynamic of the portfolio's value, while achieving the planned profit, which is the objective of the investment. The management involves, in this case, the acceptance and daily implementation in practice of a collection of principles related to the size of open positions, of the expected risk and of the markets we undertake.

**A valid system of money management takes into account the following:**

1. Size of portfolio
2. Control over the loss – using the order Stop Loss
3. Earnings protection
4. Rate risk-benefits
5. Using the obtained profits

Efficient use of a money management system will ease the maximization of the profits on long term and at the same time the limitation of the losses, independently by the efficiency degree of the transactions.

### Portfolio value

In principle, each investor must establish from the beginning how much from its account value will assign to each transaction. This proportion should not represent the maximum loss distributed to that transactions but the money allocated in margin. The share assigned to each transaction it mustn't exceed 30% from the account value. The exact value must be chosen by each investor in part depending on the own aversion to risk.

### Losses control

If the loss is the only thing that an investor can control, then before opening a position, he must determine the maximum acceptable loss. As share the maximum loss if of 5% from the account value. The loss control is achieved through the Stop Loss orders. Next we want to exemplify the choice of exposure and the level of stop loss. [4]

As assumption are taken the followings:

Initial Capital = 10.000 USD

Maximum Exposure – 30% from the initial capital

Maximum loss – 4% from the initial capital

EURUSD – 4.4000

The margin blocked in transaction it is:  
3000 USD (30% of 10.000 USD)

Margin for a lot EURUSD

1000 USD X 4.4000 = 4400 USD

Traded volume:

3000 USD/4400 USD = 0.60 lots (0.68)

Accepted maximum loss is – 4% X 10.000 USD = 400 USD

Pip value (0.6 lots) for EURUSD = 6 USD

400 USD / 6 USD = 66.666, so there are 66 pips

Setting the Stop Loss level is based on the chart, level that if it is touched it negates

the previous scenario (lines of support/resistance). Example: The investor forecasts the course growth and it opens a buying position at the level 1.4712.

Opening the last minimum at the level 1.4636 contradicts the scenario so it is recommended to place a order of Stop Loss below this level.

Breaking the support is the denial of the scenario, as we can observe an on the graphic once rejected the course on graphic it is indicated to place the order of Stop Loss with 1-2 pips below the support level. It is indicated thus, to open a buy position after it was touched the support line. In the same time we observe on the chart bellow that once reached the Stop Loss the chart continued a downward trend.

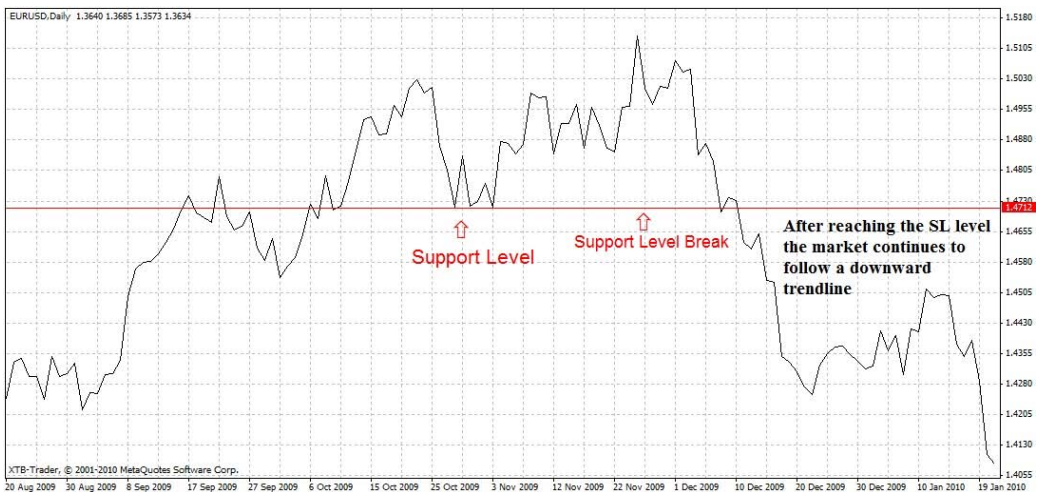


Figure 1 The example of Support Level Break

The optimal method for determining the level of Stop Loss is the result of the last two methods presented, but based on the money management and technical analysis. Based on the graphic the investor should determine how many listing steps are of the current level of the price to the Stop Loss order placed at the level of the line of support/resistance.

From the Money Management point of view the investor must establish the volume that it allows the choice of the previous level of Stop Loss, without the possible maximum

loss to exceed certain percentages from the trading account, for example 4%.

An investor opens a buying position at the level 1.4712. The optimal quotation of Stop Loss is under the level of the last minimum at 1.4636 (76 pips). The investor mustn't choose a traded volume which it would allow a greater loss than 4% from the overall value of the account(10.000 USD), meaning a maximum loss of 400 USD.  
400 USD/76 pips = 5.26 USD.

The investor mustn't choose a traded volume according to the value of a quotation of maximum 5.25 USD.

**Stop Loss Statistical Analysis**

**Investor 1**

Profit: 20%  
Loss: variable (closing the transaction because of emotions)

Efficiency: 50%

**Investor 2**

Profit 10%

Loss: 3%

Efficiency: 33%

Below we have presented the statistical positions of the two investors in which the first one doesn't use the money management system and the order of Stop Loss, and the second uses the money management system and the Stop Loss order. So there can be observed the difference in yield results at the end: the first investor ending with a total of 8815 USD and the second one ending in profit with 857 USD in addition that is a final result of 10857 USD.

Table 1 Statistical position of the two investors (USD values)

Investor 1		Investor 2	
10000	+20%	10000	+10%
12000	- 10%	11000	- 3%
10800	+20%	10770	- 3%
12960	- 25%	10447	- 3%
9720	+ 20%	10134	+ 10%
11664	- 35%	11147	- 3%
7582	+20%	10813	- 3%
9098	- 15%	10489	- 3%
7733	+ 20%	10175	+10%
9279	- 5%	11192	- 3%
Total 8815		Total 10857	



Figure 2 Example of using the SL order, and transformation of Resistance level into Support level

**Conservation of profits**

When an investor obtains an increasing profit, the conservation of the profits by changing the level of Stop Loss is an important guarantee. Change of the Stop Loss level is analyzed on the base of

technical analysis and namely of the lines of support and resistance.

**Report risk – benefits**

It is a question that we must ask ourselves at the beginning. How big should be the percentage of efficiency?

30%?  
60%?  
90%?

Any investor as it is well know controls only the possible loses. No investor knows the size of the initial portfolio. The report risk – benefits helps at obtaining profits without taking into account the efficiency of the transactions. The minimum benefits should be at least 3 times higher than the maximum possible losses. Report Risk-benefits minimum = 1:3

#### **Using the generated profits (an important decision)**

When is obtained a profit it must be put the following question: I should reinvest the profits or withdraw the earned money?

The final decision depends on each person in the idea that the withdraws are necessary as and an important source of motivation, but on the other side reinvesting money increases the possibility of occurring new higher earnings in the future.

#### **Diversification**

One of the most important aspects of Money Management is the diversification of the investments. The investor must analyze the existent correlation between the markets on which he is investing. It is preferable that the investments to be made on markets with correlation coefficient very low.

#### **CONCLUSIONS**

The money management is a part of the trading process that deals with the percentage allocation of the capital on each transaction in part. The importance of money management consists in maximizing the benefits and minimizing the losses. The wise management of the money it is an art that allows the generation of benefits inclusive in situation with an unfavorable forecasts.

Generally speaking, there are two ways to practice a successful money management. An investor can take many frequent small stops and will try to collect small profit from the few gains, or an investor can choose to go for smaller gains, and will put the Stop order pretty far hoping that those small profits will exceed the great loss of which will have.

The safest way of trading is by creating the own style primarily of trading. The trading itself is easy, but the psychological effect is the one that make harder for the decisions to be taken. Therefore one of the most important factors which help to achieve success on the forex market is the psychological preparation of the investor to accept risks and the capacity to take decisions from the investments domain under the influence of stress.

To be able to trade profitably, the investor must first prepare themselves psychologically, because it is what makes it hard to take decisions. In conclusion, the money management system is destined to keep in game the investor, despite his losses.

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