

Guglielmo Maria Caporale, Luis Gil-Alana & Alex Plastun

Searching for Inefficiencies in Exchange Rate Dynamics

#### Abstract

This paper develops a new pair trading method to detect inefficiencies in exchange rates movements and arbitrage opportunities using a convergence/divergence indicator (CDI) belonging to the oscillatory class. The proposed technique is applied to 11 exchange rates over the period 2010–2015, and trading rules based on CDI signals are obtained. The CDI indicator is shown to outperform others of the oscillatory class and in some cases (for EURAUD and AUDJPY) to generate profits. The suggested approach is of general interest and can be applied to different financial markets and assets.

Keywords: Pair trading, Oscillator, Trading strategy, Convergence/divergence indicator (CDI), Exchange rates