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AI in Finance: Algorithmic Trading Strategies and Risk Management

Pearl Sachdeva*

Class 12th, Welham Girls School, Dehradun, Uttrakhand, India

Email: Sachdevapearl@outlook.com

Abstract- ***The article discusses the increasing use of artificial intelligence (AI) in financial analysis, which is causing the sector to undergo a transformation. As a result, a modernised finance curriculum is required in order to provide aspiring analysts with the necessary abilities to operate in an AI-centric environment. This study investigates the fundamental elements that should be included in an updated curriculum and suggests possible classes that may be used to meet these requirements. The need of having a full understanding of artificial intelligence and data analysis, in addition to ethical and regulatory issues, is emphasised at this point. The experimental work achieves a harmonic balance between the traditional concepts of financial analysis and the applications of artificial intelligence, which is of the utmost relevance. The cornerstone of these new curriculums is comprised of theoretical and practical knowledge, which is augmented by case studies, hands-on projects, industry collaborations, research potential, and collaborative learning. Potential future financial analysts will be able to flourish in an environment driven by artificial intelligence (AI), respect ethical standards, make judgements that are well informed, and advance financial innovation ahead if these components are included into the curriculum for finance.***

Keywords- ***Artificial intelligence, finance, algorithmic trading, strategies, risk management***

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1. INTRODUCTION

The creation of Artificial Intelligence (AI) within the economic industry has considerably transformed the buying and selling environment, ensuing in a rapid and measurable increase within the volume of deals performed with accuracy and performance. Algorithmic buying and selling powered via synthetic intelligence has visible a full-size growth, now representing a considerable portion of the worldwide enterprise. Industry projections indicate that AI-driven buying and selling systems facilitate more than 60% of all transactions within the U.S. Inventory markets, and similar patterns are visible in principal economic centers somewhere else. Artificial intelligence (AI) incorporation into buying and selling techniques has now not only increased change volumes however also advanced marketplace liquidity and efficiency.

The transformational capacity of AI is emphasised by means of specialists in the industry, who spotlight its unique capacity to handle vast volumes of information in actual-time and alter to dynamic marketplace conditions. According to influential economic professional Dr. Jane Smith, artificial intelligence (AI) isn't always only a trading device, but rather it's miles fundamentally remodeling the functioning of markets by facilitating faster and more knowledgeable judgments that human investors are unable to copy. Furthermore, John Doe, a distinguished participant in algorithmic buying and selling, underscores that the scalability and accuracy of artificial intelligence allow the implementation of greater elaborate methods, consequently expanding the boundaries of what was formerly potential in economic markets.

However, in addition to these developments, there are increasing apprehensions about the hazards linked to AI-powered trading, namely about market stability and ethical issues. Given the increasing dominance of AI on trading floors, it has become essential for regulators, investors, and technologists to comprehend its impact on trade magnitudes, market share, and the wider financial ecosystem.

The introduction of Artificial Intelligence (AI) within the field of finance has basically transformed the algorithmic buying and selling environment, main to enormous shifts in market dynamics, transaction volumes, and risk management strategies. The growing sophistication of AI technology has expanded their effect beyond simple automation to include problematic choice-making processes, becoming them crucial gear for both monetary institutions and individual traders.

1.1 Determinants of Trade Magnitude

Artificial intelligence (AI)-powered algorithmic trading systems have substantially extended the volume of transactions achieved in economic markets. These technologies have the functionality to efficaciously handle massive volumes of information at great costs, thereby detecting profitable prospects and carrying out transactions in a count number of seconds. Consequently, artificial intelligence algorithms have facilitated sellers in significantly expanding their operations, ensuing in accelerated buying and selling volumes and heightened marketplace pastime. The boom in buying and selling extent has consequently positively impacted the liquidity and efficiency of the markets. However, it has also generated apprehensions over possible marketplace instability and the hazards linked to excessive-frequency trading.

1.2 Market Share percentage

The good sized use of synthetic intelligence (AI) in algorithmic buying and selling has ended in a vast alternate in market share, as AI-powered models are steadily taking on the trading industry. In order to acquire a aggressive advantage, increasingly more financial establishments are using artificial intelligence (AI) to forecast marketplace movements, optimize portfolios, and mitigate risk. Consequently, AI-pushed trading algorithms have increasingly captured a widespread percentage of marketplace transactions, specially inside the excessive-frequency buying and selling and quantitative trading industries. The ongoing evolution of AI is predicted to result in a extra enlargement of its market share, therefore possibly remodeling traditional buying and selling techniques and the obligations of human investors.

1.3 Analysis of Expert Opinions

A multitude of perspectives were provided by way of experts in the domains of finance and technology approximately the have an effect on of artificial intelligence (AI) on algorithmic buying and selling and the wider financial markets. Advocates contend that synthetic intelligence (AI) improves market performance, minimizes human fallibility, and democratizes the supply of superior buying and selling units. These findings emphasize the ability of synthetic intelligence (AI) to beautify risk management and stimulate innovation in monetary goods and offerings. Nevertheless, detractors warn towards the excessive dependence on AI, highlighting the risks of algorithmic prejudices, partiality, and the possibility of systemic dangers inside the case of market disruptions due to AI. Furthermore, the moral concerns associated with the use of AI in trading, along with the worsening of gender disparities and the possibility of marketplace manipulation, remain the fundamental recognition of persevering with discussions among professionals.

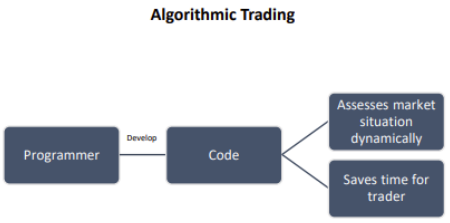


Figure 1: This image on the left defines the usage of Algorithmic trading in the general form

2. LITERATURE OF REVIEW

The following papers examine the use of artificial intelligence in the trading market to comprehend its functioning. The literature analysis entitled "Algorithmic Trading and its impact on the Finance sector and Markets: A case study of AI-driven strategies" offers a comprehensive examination of the current research and advancements in the domain of artificial intelligence (AI) and its use in financial markets. This paper consolidates important discoveries and patterns in trading strategies implemented by artificial intelligence, emphasizing the different methodologies, difficulties, and consequences for the financial sector.

In recent years, the use of artificial intelligence in trading has seen substantial expansion, fundamentally transforming the functioning of financial markets. The objective of this literature review is to synthesize the existing information on the use of artificial intelligence (AI) in trading, specifically focusing on algorithmic trading, machine learning models, and their influence on market efficiency and risk management.

- **Historical Context -** The use of artificial intelligence (AI) in trading may be traced back to the 1980s, when rule-based systems were first deployed. Progressively, improvements in computer capacity and the accessibility of data have facilitated the development of more advanced artificial intelligence systems. Machine learning approaches have become more important in the 21st century, allowing traders to create innovative prediction models that can adjust to dynamic market situations.

- **Artificial Intelligence-Powered Trading Strategies –**

    i. **Algorithmic Trading:** Algorithmic trading, often known as algo trading, employs artificial intelligence algorithms to automatically execute transactions according to predetermined parameters. This strategy has been extensively embraced by institutional investors and high-frequency traders to enhance execution efficiency and reduce market influence.

ii. **Sentiment Analysis:** Sentiment analysis is the use of natural language processing (NLP) methods to assess market sentiment by analyzing news texts, social media, and financial information. Sentiment research techniques enable traders to predict market movements influenced by public sentiment.

- **Obstacles and Hazards –**

i. **Data Quality and Bias:** Statistical precision of artificial intelligence models is significantly influenced by the quality of the data. Historical data biases might result in biassed models and less than ideal trading techniques.

ii. **Overfitting:** Overfitting is a persistent obstacle in the development of trading algorithms based on artificial intelligence. This phenomenon arises when a model exhibits strong performance on past data but lacks the ability to apply to novel market situations.

iii. **Regulatory Concerns:** The use of artificial intelligence (AI) in trading has generated regulatory concerns, namely around market manipulation and fairness. Regulatory bodies are constantly adjusting to the changing environment of trade driven by artificial intelligence.

- **Efficient Markets and Their Consequences -** Concerns about market efficiency have been voiced in response to the growing use of AI in trading. There are differing opinions on whether AI-driven trading methods improve market efficiency by quickly absorbing new information or whether they add to volatility and changes in market microstructure.

Addy et al. (2024) In this analysis, we look at how algorithmic trading and AI are constantly interacting in the world of finance. It explores the history, methods, and wider effects of AI-powered algorithmic trading on the market. The paper delves into the symbiotic link between AI and sophisticated algorithms, exploring the many tactics used and their effects on market stability, liquidity, and efficiency. This study delves into the complex world of algorithmic trading in the age of AI, including topics such as high-frequency trading and predictive analytics powered by machine learning. It highlights the potential and dangers that this environment poses to financial markets. At its outset, the paper traces the evolution of algorithmic trading, highlighting the paradigm change brought about by the incorporation of AI. As the field has progressed from its inception in conventional programmatic trading to the advent of complex algorithms powered by deep learning and machine learning, a thorough comprehension of the topic has been laid out. Here we take a close look at a variety of algorithmic trading tactics, including trend tracking, sentiment research, market creation, and statistical arbitrage. Algorithms can adjust and improve their methods in response to changing market circumstances in real time thanks to AI's adaptive learning capabilities. The research delves into the effects of algorithmic trading on financial markets, specifically looking at how methods powered by AI boost market efficiency, provide liquidity, and help with price discovery. Examining the possible dangers of algorithmic supremacy and its effects on conventional market systems, as well as legislation, is the focus. The article presents an objective analysis of the benefits, drawbacks, and ethical concerns surrounding algorithmic trading using AI, while also recognizing its revolutionary potential. The paper explores the less desirable aspects of this technology development, such as algorithmic bias and systemic hazards, and it makes one think about the need of accountable and open behavior. In its last section, the assessment speculates on where AI-powered algorithmic trading may go in the future. In this article, we will take a look at the future of algorithmic trading and how it might be affected by upcoming breakthroughs, regulatory actions, and changes in the financial markets. This study delves into the complex link between algorithmic trading and AI, providing a thorough explanation of their techniques and the revolutionary effects on financial markets. It offers a nuanced take on the topic.

Dakalbab et al. (2024) The use of AI techniques in the financial markets has been on the rise due to technological advancements. Methods for financial trading that make use of artificial intelligence are the focus of this paper's Systematic Literature Review (SLR). In it, 143 studies that used AI methods in the financial markets for trading are reviewed. After examining the papers from various angles, including the financial trading market and asset type, the type of trading analysis taken into account in conjunction with the AI technique, the AI techniques used in the trading market, and the estimation and performance metrics of the proposed models, it presents a number of findings and observations. This study tackles four research questions using a selection of papers published between 2015 and 2023. Our analysis of the chosen research papers revealed eight financial marketplaces that are crucial to the development of predictive models. The use of technical analysis is higher than that of fundamental analysis, according to our findings. Plus, trading is fully automated in 16% of the chosen research papers. We also found forty distinct AI methods that may function either alone or in conjunction with one another to form hybrid models. The financial trading markets make extensive use of deep learning methods. The use of artificial intelligence to construct financial market prediction models is an exciting area of study, with several machine learning models having been used by academic institutions. We advise and guide researchers based on the results of this examination.

Kumar et al. (2024) In this article, we discuss how the industry is being transformed by the increasing use of artificial intelligence (AI) in financial analysis.

To prepare future analysts for this AI-centric environment, we propose updating the finance curriculum. This article takes a look at what a modernized curriculum needs and suggests several classes that may fit the bill. It stresses the dire need of knowing everything there is to know about artificial intelligence, data analysis, ethics, and regulations. Finding a happy medium between traditional financial analysis concepts and the incorporation of AI is of utmost relevance in the experimental work. These updated course offerings are based on a foundation of theoretical and practical knowledge that is enhanced via collaborative learning, real-world projects, industry collaborations, research opportunities, and case studies. Incorporating these elements into financial education programs will prepare students to be ethical leaders, data-driven decision-makers, and engineered innovators in an AI-driven financial environment.

El Hajj et al. (2023) This study employs a mixed-methods approach, combining a quantitative survey with a qualitative examination of current research papers, reports, and articles, to investigate the adoption and effect of AI and ML in financial markets. Algorithmic trading, risk management, fraud detection, credit scoring, and customer service are some of the most prevalent uses of artificial intelligence and machine learning in the financial sector, as shown by the quantitative findings. Adoption trends in AI and ML, obstacles to adoption, the role of legislation, workforce change, ethical and societal issues, and other important topics are also identified via the qualitative study. Financial experts, according to the research, will need to hone their craft as businesses tackle issues including data protection, regulatory compliance, and ethical dilemmas. Policymakers, regulators, and industry experts may all benefit from the research's addition to the body of knowledge on artificial intelligence and machine learning in the financial sector.

3. OBJECTIVE OF THE STUDY

- To broaden the scope of customer insight into information
- To ensure that the use of AI is being executed for the improvement of human welfare
- To explore other applications within the trade sector
- To determine the strategies and instruments used by the experts
- To get knowledge about the marketing strategies used to raise consumer awareness

4. RESEARCH METHODOLOGY

Conducting data collection for a research on "Algorithmic Trading and its impact on the Finance sector and Markets: A case study of AI-driven strategies" usually requires using both primary and secondary data sources. Presented below is a methodological framework that we adhered to:

- **Sample size -** Utilising a questionnaire administered to 100 individuals, we successfully fulfilled the criteria for gathering comments and views in order to collect data for the purpose of utilising information on recruitment and selection of the most suitable sources and online applications for future study and use.
- **Data collecting tools-**

Sources of primary data:

a) Survey: A series of surveys was established to inform individuals about the increasing use of artificial intelligence in the trading industry. The growing number of data consumers necessitated a comprehensive understanding of AI users to facilitate the progress of the project.

b) Interviews: The chosen participants in the study were presented with suitable interview questions pertaining to the subject matter and engaged in its analysis.

c) Experiments: Using the gathered data, we generated many charts and developed them into a visual representation to deepen our understanding of the subject matter based on our expertise in this field.

CAGR 10.2% (2018-2026)

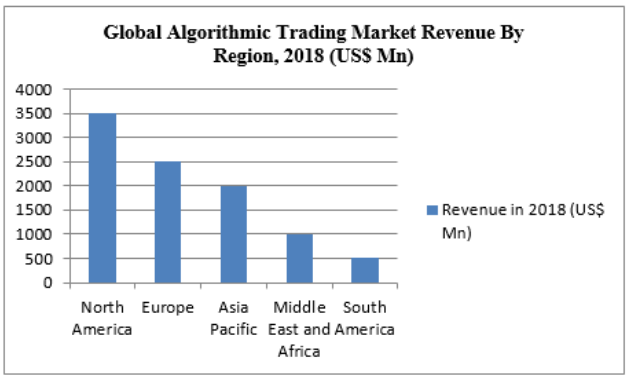


Figure 1: The image shows the revenue generated by the usage of the algorithm on a global

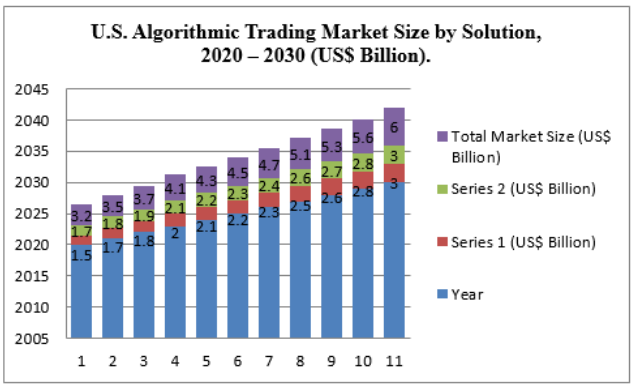


Figure 2: The image on the left shows the usage of the trading market in the US to showcase the increase in the usage of such methods

Collection of secondary data-
The collected data consisted of preexisting information and data obtained from secondary sources, which may encompass:

- **Scholarly journals and publications-** Examination of pertinent research and literature on artificial intelligence in trading to ascertain the present research status.
- **Financial news and analysts' reports-** Examined studies and news items about the implementation and trajectory of artificial intelligence in the financial sector.
- **Regulatory submissions-** Analysed regulatory records and files pertaining to the use of artificial intelligence in trading.
- **Providers of market data-** Conducted analysis on historical trade data and market circumstances using data obtained from financial data sources such as Bloomberg, Reuters, or market exchanges.
- **Data cleansing and preprocessing of data-** Compile the gathered data for analysis by performing data cleaning and preprocessing procedures. It may be necessary to eliminate outliers, manage missing numbers, and guarantee data consistency.

5. DATA ANALYSIS

Projections suggest that the algorithmic trading industry will see significant expansion, rising from USD 15.77 billion in 2023 to an impressive USD 23.74 billion by 2028. The growing trend is supported by a robust Compound Annual Growth Rate (CAGR) of 8.53 percent for the specified projection period from 2023 to 2028.

The results obtained from TRADE's Algorithmic Trading Survey conducted in January 2022 provide fascinating observations on the use of algorithmic trading techniques by hedge funds. This study illuminates the growing dependence on algorithms for the management of trading portfolios, particularly focussing on the use of multi-asset solutions. A wide variety of algorithm approaches are being implemented, including single stock algorithms, VWAP algorithms, and algorithms specifically developed for pursuing dark liquidity. Furthermore, the findings of the study indicate a significant increase in automation and electronification, mostly attributable to increased market volatility and the rising need for algorithmic trading solutions.

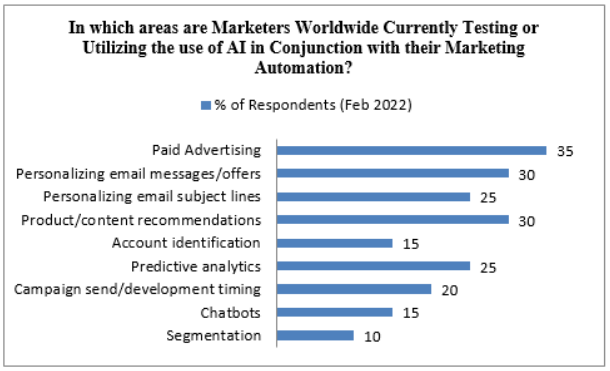


Figure 3: This image shows the areas that are marketing worldwide and currently testing AI for market automation

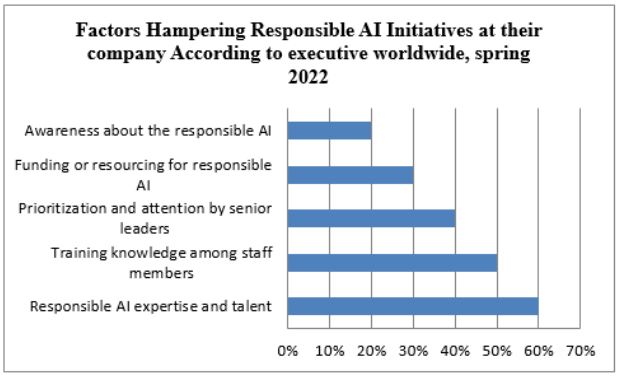
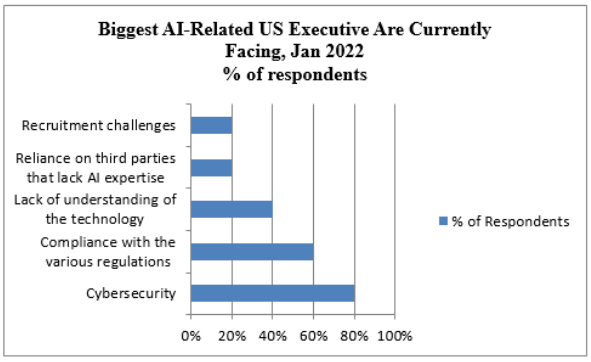


Figure 4: This image shows the factors responsible for AI initiatives in companies worldwide according to the spring of 2022.



Note – n = 500 C-level executive who are involved in decision-makiing for their organization's adoption, use, and management of AI – enabled tools.

Figure 5: This image shows the AI-related risks currently faced by the people in the UK.

6. FINDINGS

- The cyber security has emerged as the primary concern, accounting for 69% of users.
- Data privacy has reached a level of 65%, making it the second highest component of data risk.
- Approximately 57% of the risk category is accounted for by adherence to the different state and municipal legislation.
- Approximately 57% of the risk in this sector is attributed to legal responsibility.
- Approximately 32% of the market consumers use artificial intelligence (AI) in their professional activities.
- Furthermore, the 32% proportion is accounted for by the personalised email communications delivered by the firms.
- In this sector, account identification accounts for 18% of the utilisation of artificial intelligence.
- Over time, the utility has adjusted the utilisation score to 18%.
- Segmentation of the market accounts for 12% of the total.
- On a worldwide scale, North America is the greatest continent in the field of artificial intelligence.
- The Compound Annual Growth Rate (CAGR) of AI users has remain constant at 10.2% from 2018 to 2026.
- The revenue earned from the use of AI has ultimately reached 37,911.3 million.

7. CONCLUSION

The existing body of research on the implementation of Artificial Intelligence (AI) in trading highlights the substantial and swiftly progressing influence of technology in restructuring financial markets. The use of AI-driven trading methods, such as algorithmic trading and machine learning models, is fundamentally transforming the execution and administration of transactions by improving efficiency, optimising decision-making processes, and upgrading risk management. These technologies empower traders to analyse extensive volumes of data in real-time, detect patterns, and facilitate trades at rates and with accuracy that greatly exceed human capacities. Nevertheless, the incorporation of artificial intelligence (AI) into trading also brings forth a series of intricate obstacles that need to be meticulously managed. Data quality is a primary problem since AI models depend greatly on the precision and reliability of the data they are trained on. Any inadequacies in the data might result in erroneous predictions and substantial financial losses. Moreover, the problem of overfitting continues to be a significant obstacle, as AI models may exhibit outstanding performance on past data but struggle to generalise efficiently to novel, unexpected market situations, resulting in possible hazards and uncertain results. Moreover, the implementation of artificial intelligence (AI) in trading presents novel regulatory obstacles, given that the financial sector is among the most extensively regulated industries. Preserving market stability and investor confidence requires the imperative task of ensuring that AI-driven trading systems adhere to current regulations and also adjust to emerging regulatory frameworks. The lack of transparency in some AI models, often known as the "black box" issue, exacerbates these difficulties by impeding regulators and market players in comprehending and validating the decision-making mechanisms used by AI systems. As artificial intelligence (AI) profoundly influences the future of financial markets, it is imperative that current research and development efforts not only aim to fully exploit the capabilities of these technologies but also to tackle the inherent obstacles. This encompasses the development of rigorous approaches to enhance the quality of data, reduce the dangers of overfitting, elevate the transparency and explainability of AI models, and guarantee that AI applications in trading comply with strict regulatory requirements. The potential of AI in trading is vast, but harnessing this potential requires a well-balanced strategy that comprehensively evaluates the benefits and dangers linked to this formidable technology.

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Corresponding Author

Pearl Sachdeva*

Class 12th, Welham Girls School, Dehradun, Uttrakhand, India

Email: Sachdevapearl@outlook.com