



## MANAGING RISK

I write a lot in my DRIVE THRU blogs and on twitter about MONEY / RISK MANAGEMENT and using proper MONEY MANAGEMENT and ACCOUNT MANAGEMENT controls.

The amount as a rough rule of thumb to predetermine the maximum percentage of total account equity that one is prepared to risk per trade is between 0.5% and 1.0%

This discipline has two big benefits:

Firstly, it prevents “heavy / big losses” occurring from any single trade since the size of each position would be adjusted to fit within the maximum % risk of total equity that you have listed in your TRADING PLAN.

Secondly, this discipline prevents continued “heavy / big losses” during a continued streak of loss making trades. This can happen and it is awful to experience, but if you trade consistently with discipline you prevent your account suffering huge losses that can wipe out your account very quickly.

From your TRADING PLAN, you will already have your risk in pips calculated and your entry and stop and lot size calculated.

TRADE EXAMPLE: -

1. Let's assume for the purpose of an example that you have already decided in your trade plan that your risk tolerance is 1% of total equity per trade placed. Your account has a balance of \$10,000.00. This means that your risk = \$100.00.
2. The trade in question that you are considering requires at 47pip stop loss to meet the pivot points or Fibonacci levels. That will offer support to the trade and in accordance with you TRADING PLAN these are your trading parameters.

3. Trading Standard lots =  $47\text{ pips} \times \$10.00 = \$470.00$  – this trade is not possible within your TRADING PLAN guidelines.
4. What do you do next? The great flexibility for Forex trading is that you can adjust your trade size to fit the risk. There are three values to the three lot sizes available.  
Standard Lots at \$10.00 each  
Mini Lots at \$1.00 each  
Micro Lots at \$0.10 cents each
5. Instead of approaching this trade with Standard lots, look at the lot size lower. Trading Mini lots at a value of \$1.00 each gives you the following opportunity: ( $\$100 / 47 = 2.12$  lots maximum to meet your risk tolerance of \$200 for this trade example)

Therefore if you take this trade with 2 x Mini lots your maximum risk based on a 47 pip stop is  $2 \times 47 = \$94.00$  (under the 2% / \$100 risk tolerance as per your TRADING PLAN).

The decision whether to enter a trade becomes a simple question of the risk-to-reward ratio. As I have written many times, before I enter a trade I know what my risk is first before I even place the trade with my broker.

Many traders will write a “winning percentage”, I hate the terms winning and losing. Trading is not similar to being in Las Vegas. You are a RISK ASSESSOR, you have loss making trades and you have profitable trades, it is NOT gambling like sitting at a roulette table in Las Vegas.

Now, please do not misunderstand me, your percentage of profitable trades is important to know, but it is NOT an indicator of how good your trading strategy is. Strategy defines success, and success equals \$\$\$\$\$. Using percentages to define success or failure in trading can make you focus on recent trades only. You could lose sight of the big picture, and this could lead to overconfidence and deviation from your TRADING PLAN and, the strict discipline guidelines and this could lead to “revenge” or “desperation” trades.

Longer-term traders can run the risk of developing the rather destructive habit of wanting to be right rather than being successful. To this end, many traders will take profits off the table early to be right and achieve a profitable trade rather than letting a profitable trade run. This habit can also lead to letting loss-making trades run too far away, you move stops and break your TRADING PLAN guidelines for trading.

In my book, there is only one way to truly measure trading success and that sustained profitability.

This is why having a TRADING PLAN detailing a RISK AND ACCOUNT MANAGEMENT plan with discipline is an absolute essential part of any successful trading strategy, without one, in my opinion sustained profitability is virtually impossible.

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