The Ultimate Guide Towards Risk Management

Defining Your Risk



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Dear Traders,

I truly understand that you are aspiring to make it in the field of trading forex. It is also true that knowledge without sound risk management and good psychology towards your approach in the market is a total waste of time.

I have thus taken my time to prepare an ultimate guide to risk management as you prepare for the release of the Psychology primer and many more to come.

It is with Sound risk management and good psychology that consistency steps in the market. Once that happens, you have a refined statistical edge and hence your wins are upgraded.

Take your time, study the PDF, digest and put into practice whatever you will learn.

Our aim is to be profitable in the long run and nothing more. Hope you find it beneficial and good luck in your trading career.

PeaceFx

RISK WARNING

Before deciding to participate in the Forex Market, you should carefully consider your investment objectives, level of experience and risk appetite. Most importantly, do not invest money you cannot afford to lose.

There is considerable exposure to risk in any off-exchange foreign exchange transactions, including, but not limited to, leverage, creditworthiness, limited regulatory protection and market volatility that may substantially affect the price or liquidity of a currency or currency pair.

Moreover, the leveraged nature of Forex Trading means that any market movement will have an equally proportional effect on your deposited funds. This may work against you as well as for you.

The possibility exists that you could sustain a total loss of initial margin funds and be required to deposit additional funds to maintain your position. If you fail to meet any margin requirement, your position(s) may be liquidated, and you will be responsible for any resulting losses.

There are risks associated with utilizing an internet-based trading system, including, but not limited to, the failure of hardware, software and internet connection. Your broker is not responsible for communication failures or delays when trading via the internet.

I, PeaceFx, am NOT a Financial Advisor.

Trading is a risky business.

Before taking part in it, understand the risks associated. Past performances cannot guarantee future outcomes and therefore,

INVEST IN WHAT YOU CAN AFFORD TO LOSE!

RISK MANAGEMENT

Risk Management is the process you use to mitigate or protect your personal trading account from the danger of losing all your account balance.

Risk is defined by the likelihood, a loss will occur.

If you manage your risk, you have defined statistical edge, hence higher chances for consistency in the market.

Remember, no Holy Grail in the Forex Market. Therefore, risk management itself is just a criteria to control your risk exposure when trading.

Let us break down the risk management into 3 Layers:

1. Risk Planning
2. Trading Risk-Reward Ratio
3. Position Sizing

1. Risk Planning

This is essential in your trading as it helps you to maintain the consistency with the risk when trading the markets. Being consistent in the market is a hard task.

The smaller portion of successful traders made it through consistency, which resulted from risk management and good psychology towards your approach in the markets. Planning your risk may come in a variety of ways but the most common one is amount you are willing to risk per trade.

The idea of amount you are willing to risk per trade is of personal preference and it comes down to your risk tolerance and risk appetite in general.

However, it is highly recommended not to risk more than 2% on any particular trading idea. The main advantage is that you will be able to make more trades at any particular time.

Determining Risk-Dollar Amount

For example;

If your account balance is $10,000 and your risk tolerance is 2%, your dollar risk amount is $200 per trade.

2/100*$10000 = $200

By calculating risk-dollar amount we can ascertain how much we are going to lose if the trade goes against us. In our particular case the maximum loss would be $200.

Risk planning will help you control the mental part of trading because you already know in advance how much you are going to make if the trade goes in your favor or how much you are going to lose if the trade goes against you.

2. Trading Risk Reward Ratio

Trading risk-reward ratio simply determines the potential loss versus potential profit on any given trade.

Risk is simply defined as the price distance between your entry and stop loss.

Reward is defined as the price distance between your entry and your take profit.

In order to calculate risk-reward, you need the following are needed;

- ✓ ENTRY PRICE
- ✓ STOP LOSS
- ✓ TAKE PROFIT

In order to determine the risk to reward ratio, you need to divide the potential "Total risk" to the potential "Total Reward".

Risk Reward Ratio = Total Risk/ Total Reward

In order to figure out the Total Risk, you need to apply the formula below;

Total Risk = Pip Value*(Entry Price - Stop Loss Price)

In order to figure out your Total Reward, you need to apply this formula;

Total Reward = Pip value*(Entry Price-Take Profit Price)

As an example;

If you want to enter a long position on EURUSD at 1.2300 with a Stop Loss at 1.2250 and a profit target at 1.2400, you are basically having a Risk-Reward ratio of 1:2

3. Position Sizing

Position sizing answers another important question of how big a particular trade should be.

There are several ways in which you can determine how big the position should be. It all depends with kind of trader you are because different traders have different personalities and trade differently.

You should be able to consider the following when calculating your position sizing;

- ✓ ACCOUNT SIZE
- ✓ AMOUNT YOU WANT TO RISK PERCENTAGE WISE
- ✓ STOP LOSS

The basic formula for calculating your position size is;

Position Size = (Account Size*%Risk per Trade)/Stop Loss

Example;

Imagine having a fictional account size of $10,000, we have a risk tolerance of 2% per trade and based on our analysis, we figure out that we need 50 pips to stop loss.

If we consider the formula, our position size would be 4 mini lots.

HOW TO MANAGE RISK WHEN TRADING

- ✓ Moving SL to BE point. This helps in removing unnecessary emotions.
- ✓ Take off some partials
- ✓ You can consider hedging
- ✓ Risk not more than 2% of your trade

Losses are part of the game just like I mentioned. Any trader not willing to take losses should pack his belongings and look for an alternative job. Do not take losses personally.

HOW TO INCREASE YOUR RISK REWARD RATIO

- ✓ Improve on your entries
- ✓ Reducing SL
- ✓ Journal your trades
- ✓ Study the winning trades that worked perfectly
- ✓ Let your winner run and cut losses quick
- ✓ Improve on your exit strategy

IMPORTANCE OF HAVING A GOOD RISK MANAGEMENT

- ✓ It enables you as a Trader to be in control of your emotions as you have already pre-determined the amount you are exposing to risk.
- ✓ It permits you to trade in a smart way and give you the flexibility as a trader to choose how much you want to risk per trade in a way that will allow you to maximize your profits and minimize your losses.
- ✓ It gives you a greater chance to survive in the Forex business.

N/B: Not following any Money Management rules has the potential to break your trading career.

ADDITIONAL INFORMATION

What differentiates Forex from a Casino is basically the use of a refined statistical edge. In as much as Losses are part of the game, we risk small to gain big and hence the minimum risk to reward ratio should be 1:2. It all depends with the strategy you are using.

SL and TP placements depends entirely on the strategy you are using. It is upon you as a trader to be reactive in whichever strategy you are using.

NO STRATEGY IS BETTER THAN THE OTHER. We are all in this business to get a piece of a pie. I will not advice in strategies to use. You as a trader you know your personality better than I do. You know what suits you. Master one strategy and die with till perfection. Mastering different strategies leads to analysis paralysis especially when they conflict each other.

That is why I mentioned, for STOP LOSS placements and TAKE PROFIT LEVELS, it entirely depends on the strategy you are using.

RISK MANAGEMENT TOGETHER WITH GOOD PSYCHOLOGY is the mother of consistency and good profitability in the market. Without these, even if your strategy is at 99% perfection, you are entirely doing zero work.

In conclusion, managing risk is the genesis of consistency and good profitability in the market. The PDF has touched on critical aspects of risk management that will straighten the curve.

Thank you!

GLGT

Essential links

All said and done, I have compiled essential links that will smoothen your trading life.

- Start Trading Currencies, Indices & Metals here
- Start Trading Volatility Index, Boom, Crash & Ranges here
- Get Unlimited FREE FOREX Learning Materials here