



The Power of Understanding Risk

The best trading software, the best trading plan, the best computer will do you absolutely no good if you don't have a healthy respect for risk.

One of the worst things that can happen for someone new to trading is to earn money right off the bat; trading will seem "easy." Now don't get me wrong, we will strive to make your trading simple and stress-free, but if you believe it is easy you will only see one side of the street.

Easy and simple are not the same thing. I have managed proprietary trading offices and literally hundreds of traders over the last ten years and can help you keep thousands of dollars in your pocket with the report you are reading.

When a trader believes trading is "easy" they will not prepare for downside to a trade. When a trader believes trading is "easy", they will not be prepared for the scenario in which things don't happen the way they envisioned them. Traders like this only think about what they stand to gain, and not what they stand to lose.

I have witnessed trader after trader earn money 20 days in a row and then give it all back on one trade because they did not evaluate the risk (a dollar amount they were willing to put into the idea).

Pretty much everything I do when I teach, mentor and trade myself comes from my perspective of having been an entrepreneur for over 20 years. If you can grasp the concept I am about to impart, you will have total control over your trading.

A trading loss is nothing more than a business expense, no different than buying a desk or pencils for your office. You are spending money to make money. Wrap your head around this idea. This subtle mind shift WILL mean a huge difference in how you think when you exit a trade.

Most inexperienced or unprofitable traders exit a position that did not earn money and say it was a bad trade because it lost money. Get away from thinking this way. The most successful professionals ask themselves if they followed their plan, not whether or not they made money on the trade. Trust the process, and the results will take care of themselves.

The reason this is such a big deal is that you will come to understand that to have success you must follow your plan over many, many trades (provided it has an edge). Instead, of beating

yourself over the head because one individual trade did not produce as profit, applaud yourself for following your rules.

Money management and risk are 100% under your control; it does not matter one iota what happens next in the market if you have pre-determined your risk (as well as profit targets).

Too many traders incorrectly think consistent profitable trading is predicting what is going to happen next before it happens. I can't tell you how many traders do all the work and preparation to learn what a great idea looks like and then never earn any money on those ideas!

Great ideas that earn little to nothing

I went through this myself when I first started trading. Every day I would go home and write in my journal "good ideas again, but got 'stop-lossed' to death." (My English teacher would not like the wording of 'stop-lossed' but I don't think she is a trader) 😊

The reason this occurs is that most traders can be trained or learn how to identify a good idea, the key missing ingredient is being in the trade long enough to allow the idea to play itself out.

In other words, you have to build parameters that prevent you from getting stopped out of the position too soon. This happens more often than not because your share size is too big to ALLOW you to feel comfortable with the stock's fluctuations after you enter the position.

There are two methods to plan for how to handle this:

- 1) Trade fewer shares to compensate for the appropriate volatility
- 2) Plan to re-enter if you get stopped out.

Remember a trade that doesn't make money is simply a trade that didn't follow through after you entered. (Assuming it is a good idea that follows your plan).

Professional thought process

When you are just starting out, you most likely will have just enough buying power to get involved but not enough change your life if you happen to lose it.

A key skill to develop from the start is to build the habits of trading as if you have a very large amount of capital. Why? Because it is very easy to develop bad habits because you CAN AFFORD to be sloppy. In other words you can keep adding to a position that is not working.

Yeah, yeah I know you would never do that, but humor me anyway. If you work on the skill of getting out exactly where you said you would based on the dollar amount you planned to risk, you will not have thoughts of “give me more so I have a good average price.”

This, as we all know, is averaging down. This practice, my friend, is how to be out of the business in one or two trades.

Different considerations for risk management

Total Risk Capital: What is the total risk amount you are allocating to your trading business? Think in terms of opening a business. After you open the doors a retail operator needs to pay for insurance, inventory, electric and other stuff on top of having working capital available.

At Risk Capital: Determine how much of your risk capital could possibly be at risk at one time in the market. This is either through multiple positions or one big position. You never want to be in a position where an unexpected catastrophic event can put you out of business. More often than not, a safe amount for at risk capital is around 40%-60%.

Risk Per Trade: This number is always a fascinating one for me. Ultimately, it will boil down to your personal risk tolerance and how fast you want your heart to beat. The rule of thumb is 2% of your at risk capital. This number can and will fluctuate based on two things:

1. How well you are trading; you want to increase when you have a good read on the market.
2. The strength of your argument for the trade scenario. As you trade more you will begin to understand when the probabilities increase. When this occurs you should press the edge a little bit. It is kind of like having a better hand in a card game. You know it's a good hand and you have good chance of winning but that doesn't guarantee a win.

Positions: How many positions can you handle managing at one time? In today's era of information overload, it is very easy to find ideas. Always remember there is a big difference between ideas and good ideas. Good ideas, and good ideas that fit YOUR STRATEGY.

I am all for developing the skill of managing more than one position (and I will make the case for this later in the course, but your first skill is to be clear on what a good idea looks like while it is unfolding).

Stop loss amounts

Per day, week or month: Whether you are an Active Trader or Fundamental Trader, you will have a time period that you trade or a “standard” holding period for your trading strategy. For

example, day trader's standard holding period is typically "that day", in other words a max stop out number for the day. Someone who holds for a few days may have a stop out for the week. You get the idea.

Losing trades happen to everyone. Either the market is tough to trade, or you happen to not be in a good groove. When you do not have a good feel for the market, it is simply about putting the brakes on and limiting your losses.

Per trade: This is a rule you must never break. You must know BEFORE you put on any trade the dollar amount you plan to put at risk. We will teach you that you can and should learn to work an order (which is very different from averaging down). Working an order is simply building a position. However, this is not a license for "tiering" into a position as we teach in the Active Trader Mentor Program. Although you are not getting all the shares at the same time, you still must know your dollar amount risk for when you do have the shares you planned for.

Position sizing: As we have mentioned several times already, risk should always be a dollar amount based on several factors. Risk, however, can also be managed through position size. Think about driving. Your speed (share size) should be determined based on the distance between you and the car ahead, and how comfortable you're ability to maneuver [risk] in general. Slow down (reduce share size) and you should be able to handle any speed (volatility).

See you soon!

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