**RISK MANAGEMENT**

What is Risk Management?

Risk Management is a process that involves the identification, assessment, control and/or avoidance of an amount of loss in the forex market when taking a trade, thereby maximizing the potential of profits making by limiting the amount of loss that can be made on the trade.

In lay man’s terminology, It is the process of keeping potential losses under control.

Risk management is an important aspect of the forex market usually overlooked by many forex traders because it involves following a set of rules, planning and calculations.

It is expected that for every form of risk taken, some sort of reward should be plausible… This is termed RISK-TO-REWARD in risk management.

**CALCULATIONS IN RISK MANAGEMENT**

**PROFITS/LOSS CALCULATION**

Using Major pairs with the USD as the quote currency( e.g GBPUSD, AUDUSD),

We want to calculate how much profits would be realized on each type of lots on a move of 1 pip.

For a standard lot ($100 000) = 1 LOT

And a pip movement given by 0.00010

Profits realized = lotsize (or volume) x pip movement

= $100 000 x 0.00010

= $10

For a mini lot ($10 000) = 0.1 LOT

And a pip movement given by 0.00010

Profits realized = lotsize (or volume) x pip movement

= $10 000 x 0.00010

= $1

For a micro lot ($1 000) = 0.01 LOT

And a pip movement given by 0.00010

Profits realized = lotsize (or volume) x pip movement

= $1 000 x 0.00010

= $0.1

Here are some examples to ensure comprehension

EG. If GBPUSD moves from 1.21250 to 1.21750 in the BUY direction,

1. How many pips did it move?
2. If one standard lot was used to place the buy trade, how much profits was realized?
3. How much lots would have been required to make a profits of $85

SOLUTION:

1. If we subtract 1.21350 from 1.21780,

1.21750

-1.21250

0.00500

Hence it moved 50 pips or 500 pippetes (points) in total.

1. If one standard lot was used, then it means $100 000 was used to place the trade.

Where 50 pips is also = 0.00500

Total profits made = $100 000 x 0.00500

= $500

3) Firstly, we need to calculate how many lots it will require to make $1

From the answer of question 2

It took

1 lot to make $500

So it will take

X lot to make $1

1 lot = $500

X lot = $1

Cross multiply to get...

X x 1 = $500 x 1

X = 1/500

= 0.002 lots

Hence the total amount of lots required to make $85 = 0.002 x 85

= 0.170 lots

However, if you don't like to do calculations by yourself, you can go online and check for FOREX risk calculator and you'd see a ton of them.