**CHAPTER VII**

*great gain is measured by small casualty  
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In this chapter, we’ll learn the concept of automated incremental loss cutting, which is the mechanism to substitute for retail traders’ stop losses.

**PROBLEM-SOLUTION**

So far, we’ve been discussing winning scenarios, a break-even, and one losing scenario using the Adjusted Target Price (**aTP**) mechanism. What about a winning-with-casualty scenario (some winning trades, some losing trades)?

Here, you will learn an alternative new approach to risk management so-called Automated Loss Cutting Mechanism (**ALCM**). **ALCM** is the automated process that would cut those trades that go beyond the Loss-Cutting Threshold (**LCT**), which in effect, prevents the further losses.

**PHILOSOPHY**

The nature of our trading practice is to spread a large trading position into smaller trades. It’s like sending an army division into the field to take a particular target. Sometimes the casualty is none and the mission is accomplished. Other times, the general needs to execute plan B to adjust his target. Still other times, he may lose a few of his men in order to achieve the target. This training chapter is about the latest of the three – i.e. winning the **eTP** with some trades being cut out by the Automated Loss-Cutting Mechanism (**ALCM**).

**SOLUTION**

Sometimes the market is not being too merciful to vigorous traders. You can still achieve your **eTP**. However, some casualty may be incurred. In those cases, minimizing the losing trades while keeping the majority winning trades is an art in itself.

This art relies on two crafts:

1. To choose a good entry point (**rUB**)
2. To define a precise volatility range

**STRATEGY & TACTICS**

Spreading our account capital into smaller trades will reduce the risk of being cut out by the **ALCM**. However, that itself is not enough.

A good initial entry point which is being defined by the initial **eTP** will give you more cushion when the market moves against you even beyond the **LCT**. So, as a good fund manager, don’t just define your **eTP**.

Wait! Wait until the market retraces down for about 100 price points, then define your **eTP**. This will help you to stay out of trouble and reducing the possible losing trades.

Well, actually you don’t have to wait. The alternative solution is to define the Max Upper Bound (**mUB**) of the trading range other than the **eTP**.

**DEFINITIONS**

**LCT**is the Loss-cutting threshold, which is the price point where our **ATS** automatically exits negative positions incrementally, starting from the most graved losing position.

**ATS** is the Automated Trading System. Its synonyms are **ATR** (Automated Trading Robots), or **AITS** (Artificial Intelligence Trading System).

**ALCM** is the Automated Loss-Cutting Mechanism. When the market moves beyond the **LCT**, our **ATS** will commission an Artificial Intelligence (AI) process/robot to eliminate losing trades, beginning with the most gravely negative trades.

**ieTP** is the initial **eTP**. It improves the **TO** by reducing the risk of the market volatility moving beyond the **LCT**.

**aLoss** is the price point distance from the **LCT** to the **Bottom** of the **TO** when longing gold.

**mUB** is the max upper bound. This is the alternative upper bound of the trading range (other than **eTP**) if you want to fine-tune the trading range to increase profit margin and most importantly reduce the risk of going beyond the **LCT**.

**CASE STUDY 7 (Lose some/Win Some scenario)**

Our trading capital is $46,000.

It’s Tuesday at noon. Let say the current gold price is 1950.

We expect gold to gain $50, so We set the profit target price to be 2000.

We are only willing to buy gold down to 1800 lower bound, which means we define the trading range from 1800 to 2000.

If gold ever gets below 1750, we incrementally exit losing positions, starting from the most losing ones.

So, we spread out our capitals, and therefore, for each price, we buy ONE ounce of gold.

However, instead of getting straight to 2000, gold drops 250 dollars to 1700 BEFORE bouncing up the next Friday morning to 2000.

What the outcome should look like?

Well, we will lose money on 50 trades, and gain on 200 other trades.

After gold drops below 1750, we incrementally closing the losing positions, from most losing first. Therefore, when gold drops to 1700, be closed 50 losing positions with-$125 per oz, which is -$6,250.

However, when gold bounces up to 2000 and we cash out for profits, we will gain 200 oz at (1800...2000) an average of $100 per oz. Therefore, our gain is $20,000.

Offset the washed-out between both losses and gains ($20,000 - $6,250), we still gain $13,750.

For a 250-Dollar price drop situation, then bounce back to the projected target price, we still make $13,750, which is about 30% in the matter of weeks, which is NOT a very bad idea for a drastic trading situation.

**FORMULA:**

**Loss = aLoss** **\* (Bottom – mTP)**

A picture containing chart

Description automatically generated

Illustration VII

**ELABORATIONS**

Think thoroughly before you execute your Trades Operation (**TO)**. Use the Pre-Trade Simulator (**PTS)** to help you to envision the trading game that you are about to get into.

Keep refining your **ieTP** until you feel that you have a good trading range with lowest risk. Work with your Risk Manager. Exploit him. It’s much easier to consult him before getting into your **TO**’s than to seek advises from him when you got stuck in bad trading situations where you may lose a few trades. Even losing only a few trades can be avoided.

Our general trading strategy is called “*trending cost-average trading*.” So, what it really means? Well, it means spreading out trades across a pre-defined trading range which is based on an assumption that gold price will follow a certain trend – going up!

Let’s break down this theory in details.

Trending means the price will move in the sloped direction. In our post-COVID business cycle we believe that it will go up for at least another ten years. So, our strategy is longing gold.

Cost average means that we do not enter large positions. Rather, we spread the capital and take smaller positions within a certain trading range. In doing this, we effective reduce the risk for each trade. Also, we can increase the error-tolerance, which in effect, removes all the panics and freak-outs if the market moves against our positions.

Error tolerance eliminates retail traders out of this high-leverage trading game. Retail traders have small fund. They overtrade. They take large positions, therefore willing to take very close stop losses. Their trades are being stopped out at high frequencies. They end up losing most, - if not all – their money.

On the other hand, hedge fund traders love error tolerance because it makes them rich. The more error tolerance allowed, the wider the trading range. The wider trading range means more trades taken, which effectively means more profits. Fund traders have more adequately funded accounts. They don’t need to overtrade. Their trades are rarely being stopped out. They end up making lots of money, devouring all the losses from retail traders.

Potential loss is a very insignificant factor for fund traders. The reason being the **LCT**’s being place too far from the defined trading ranges, which means that the odds of the losing trades being cut of by **ALCM** is very slim.

The **ACLM** is there but you should plan your **TO** in such a way that you would never have to use it – at least only use it rarely. Do not rely on it, because it will reduce your profits. Do not use it if you don’t have to. Keep refining your **ieTP** before you use it.

However, if we have to lose a few trades in order to take profits on many other trades, by all means, just do it. The net result is a huge accumulated profit. Nevertheless, in most cases, we shouldn’t have to cash loss on any trades. But if we do, it’s just part of the game.

***RECAP***

*As a general sending his men to take a certain target, he can get his target, but sometimes he may lose a few of his men. A good general will lose just a few men. A great one loses none.*

*Planning is a very important part of the operation. Proper execution of the plan is also important.*

*As a fund manager, exploit your Risk Manager skills to help you with the planning when you come up with the numbers for your****ieTP****’s. If you have good plans, then the****ALCM****has very little work to do, which is extremely beneficial to your profit line. We need the****ALCM****, but hopefully, we may never have to use it.*