

CHAPTER 12

RISK MANAGEMENT

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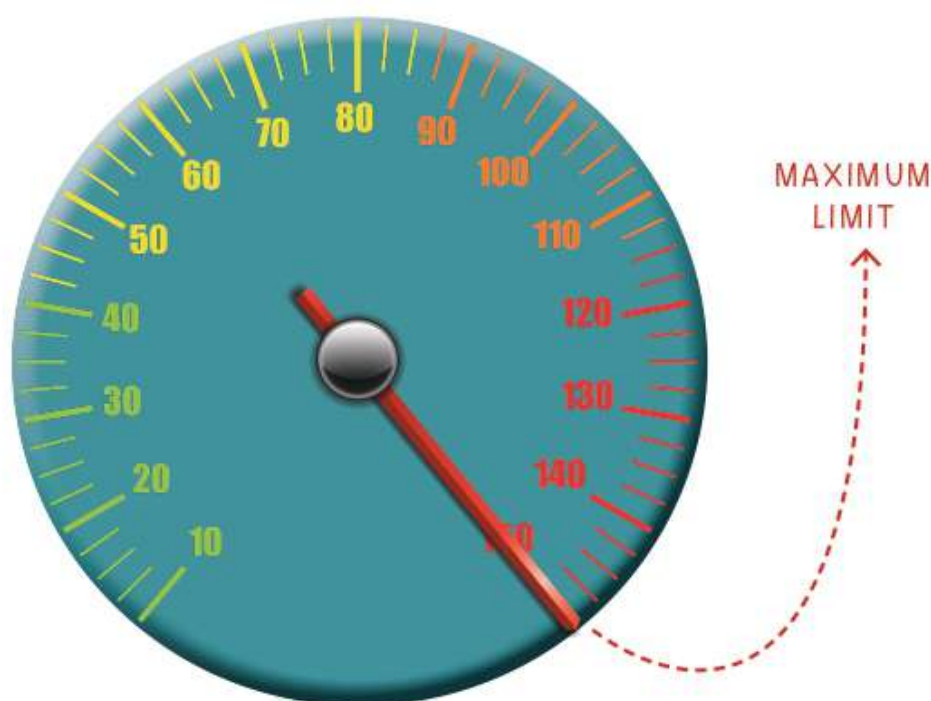


12.1 INTRODUCTION

Given the risk involved in entering the F&O markets it is crucial to understand proper risk management measures. We must keep them in mind as we move ahead in the markets. Risk Management is the core of any good trading strategy. A strategy that does not take care of risk management, will eventually suffer one day and is not sustainable. Particularly, with Futures and Options market, it is even more important as high leverage is used. We do not want to risk our survival under any circumstances in any trading position. We do not want to be in a position ever where there is even a slight possibility that we might lose more than what we have.

Even though a trade might look incredibly attractive, if there is a slight chance that you might lose everything and more, we must not enter such trades. As we are new to these markets and have limited exposure, getting into such trades can be extremely dangerous. Small losses may occur but a potential big loss that can leave us out of the market must be avoided under all circumstances.

There are countless stories where a strategy has an extremely unlikely risk but its a risk where survival is compromised. Such strategies might end up doing extremely good for 5-6 years and all of a sudden in 1 or 2 event, may leave the trader bankrupt and may take them back to where it started or even worse.



RISK MANAGEMENT SYSTEM

Risk Management has a cost to it. While we apply risk management tools to avoid unwanted risk, it may even **limit our profits** significantly.

The securities we use for risk management may be costly. At times, it may also challenge the viability of any given strategy. But it is still important to have risk management to ensure survival. It is like **Profitability v/s Survival**. A balance between the two is what we must attain while we build or follow any strategy.