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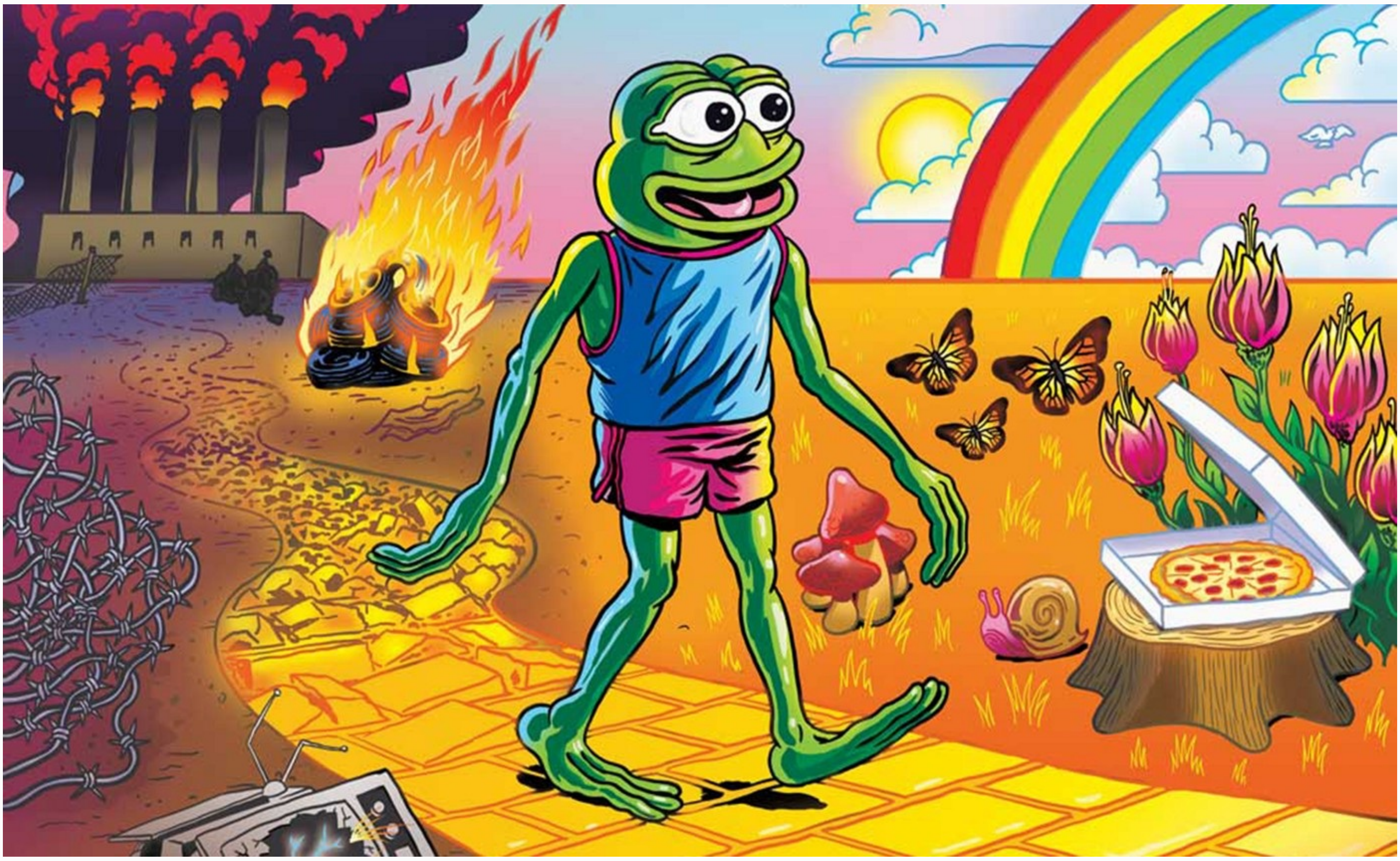
Risk Management

For new traders risk management is something that will be completely ignored, common human psychology is to look with eager eyes at the upside, whilst taking little notice of the downside. New traders don't want to learn about how to save their capital because they are too excited to 'make money.' This is probably why crypto is so popular, it provides the biggest gains out of any asset class, but what people don't understand is that it can also provide nasty downswings, destroying portfolios (many have found this out recently.) The aim of the game is to survive to be able to participate in these life-changing gains.

I believe that to be a good trader you have to blow up an account when starting. It is probably the best learning curve you can experience. I did this in April/May, and so did some of the best traders I know on CT. It is not shameful to have done this, but this piece is going to explain how to limit the losses you have by being smart. It puts you in front of 90% of traders anyways.



As I touched on above a lot of traders come in expecting to be making thousands per day, this is a fallacy, at least if u are less than 6 figures. Expecting this will be detrimental to your development. You have to realize that surviving is the aim of the game in the trading world, there will always be good new opportunities that will pop up, but if you wipe out your account, you'll never be able to capitalize on them. Going all-in on a leveraged trade is the single worst idea, you are donating to Alamedas trump fund.

I'm aiming to explain and outline good risk management tactics, and how you can integrate them properly into your trading. Although it seems boring this is probably one of the most important aspects of trading. Obviously, everyone has a different opinion on risk management, and how much risk they are happy to take, it is up to the person to determine their risk appetite.

This is a long-term game, to be honest, and a lot of you simply won't put in the time to be able to outperform some of CT that is staring at a screen for 12 hours minimum a day. If your dream is to be a trader you have to put in the time every single day, if you are here for the money then simply go gamble your money at the casino.

What is risk management?

Risk management is the 'identification, analysis, and acceptance or mitigation of uncertainty in investment decisions' according to Investopedia. Traders use risk management so that they can always make another trade, they are never 'all in'.

For small accounts, it is mentally a lot harder to stick to a risk-averse plan. I completely understand why you would want to risk more on trades, chasing that one life-changing trade. However, from experience, it is much more profitable in the long term by risking small amounts of your portfolio. Yes, you may make a trade that gives you a 20% return on your entire portfolio, but equally, you may get two trades that draw your portfolio down by 20%. It is all down to you to decide, personally, I don't want to be riding a trade down for 20% of my port, it would make no sense, not only because I would lose a lot of money, but also because I would let my emotional decision making take ahold and likely capitulate at the exact wrong moment.

Keeping your mind in check is essential when it comes to this, greed is an overriding emotion in trading, especially when you are seeing other people making massive gains, this is common on CT as a lot of people have made life-changing gains, your time will come anon. For someone who has started trading though you are never going to be making as much as someone who has been trading for 6 years. With time you will gradually improve, and become like these people posting 100k Profits, but you need to have a portfolio to be able to do that.

Now the MOST essential part of trading is determining a set amount you are willing to lose per trade. You want to ask yourself how much you're willing to risk per trade. I personally have a max risk of 2% per trade. This means I can only lose a maximum of 2% of my capital if the price moves to my max invalidation on the trade. From my own experience that works the best for me, I have been punished for holding assets with risk much higher than 2% and it has destroyed my portfolio previously. This is why I would recommend 2% being an absolute max because it gives you a lot of chances to mess up and still survive for the next day. Although I have set my max risk at 2% I personally very rarely risk this much, usually it is 1% in one trade. You can also work out a maximum loss per day, this will limit emotional trading, and mine is at 5%, if I lose more than this I have to stop trading and chill for a bit.

I set a hard stop at my max invalidation on any trade, however, I am managing it constantly, this is something I also recommend doing, especially on the lower timeframes. If the price moves fast away from you then it is easy to escape, if not then you can manually cut if needed.

There are some more broad risk management ideas and I will outline a few that I like the most here, the post I have tagged under this has ideas from many traders I respect so you guys should have a look at this too.

Great rules, some that contribute nicely to risk management.

A key mental game is to consider your profits as part of your account instead of seeing them as 'profits.' Although this seems like quite an obvious point, you would be surprised at the number of people that do not do this. By seeing your profits as profits, you are essentially validating losses if they ever come because 'they are profits anyways' that is simply a retarded way to think if I am honest. You have to protect all the money you earn, that is the aim of the game.

After you've sorted this out you then need to determine how much you're willing to risk in a day, you will likely have more than 1 trade open in a day, so think about the maximum drawdown risk you are happy having in one day. My maximum drawdown in a day is 5%, just so I know if everything goes wrong I will lose 5% of my trading stack and I can deal with that.

You would then do the same for weekly and monthly max risk. I think identifying max drawdowns is essential, especially for longer periods of time. If you are going through a bad period of trading, then you have a specific amount you can lose before you stop altogether until the next week or month. This doesn't mean you have to stop trading, but it means you won't revenge trade your whole account into the ground.

This next part is something that I personally use, although some people might not agree with me, I think it's an excellent addition to have in risk management. As I'm sure you all know there are periods of bad trading that you go through. When that is the case (I've lost 2–3 trades in a row) I will reduce my risk per trade. So because my normal risk is 1% I will halve that to 0.5% if I'm on a losing streak, and if I keep on losing to 0.25%. This is because it's a mental game when you're losing, and you have to have skin in the game regardless to get back on track, however you want to limit your losses whilst the streak is happening. It also goes the other way round though, so say I'm on a winning streak I may increase my risk from 1% to 1.5% or even to 2%, this is something I do as when I'm on a winning streak I'm a lot more confident with my trades, I'm not sure if you all feel the same but that's just how I play it.

B4 we end I would also like to point out that some ppl will have completely different risk strategies, and this is more from a lower time frame trading point of view, I respect all the diff stats and am happy if they work for you.

Hopefully, this helps you guys, any questions just ask me on Twitter. This will probably be my last article for a while as I need to do some learning of my own.