THE HOLY GRAIL OF TRADING

RISK MANAGEMENT

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The Holy Grail of Trading
Risk Management

I have tried to explain risk management aspects of trading with exercise trades and highlight the importance of it in this document.

Ken.

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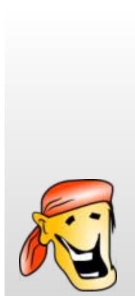


pirate of greed

Risk Management

You may have come across the subject of the Risk Management under different names, such as Money Management, Risk Management, Trade Management, Order Management and so on. Call it whatever you like but one thing is indisputable, it's the essence of trading. The most important aspect of trading. It's almost the holly grail of trading.

It's ironic though, that for new traders, Risk Management is the least important aspect of trading. Everybody wants to learn best entries and such first. They think that's where the money is. It's human nature; we usually tend to look for the easy way regardless of whether it's the correct way or not.

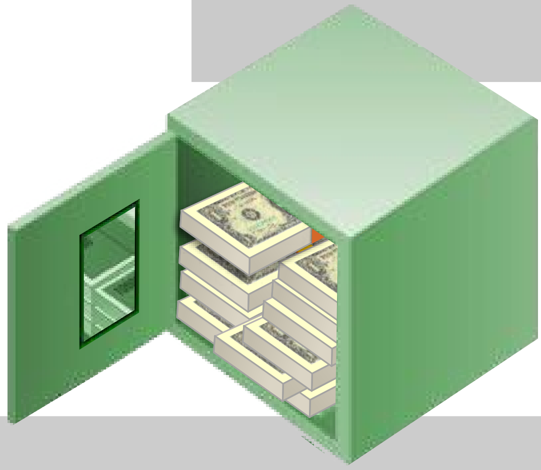
I'm a big fun of old Martial Art movies. Not the ones where they jump on top of 3 storey building with not much of an effort at all, but those where young people going to a Martial Art master to teach them his craft. When the master accept them as his student/trainee. Master asks them doing mundane jobs such as cleaning the floor, moving certain items from one place to another etc. day in day out. Eventually most students get really frustrated with extreme disappointment. After all they wanted to be a best kung-fu fighters not a handyman or cleaner.

Most drop out. The ones that stay the course, however, start to realize that Martial Arts is a life style practice, not a fighting one. They also come to understanding of mastering the art takes time and hard work.

Just like in trading... Trading is not a get rich quick scheme but rather it's an occupation with it's own lifestyle. Be warned, some may find it quite a boring occupation.

Especially after hearing and reading all those stories how so-and-so made lots of money by trading currencies. Wild west gold rush begins... Looking into it a bit further then download some trading platforms and start trading paper money.

Watching price moving.. seeing all those dollar pips rolling fast on most likely M1 and M5 charts. Sure we are excited by now and thinking the prospect of making a lot of money without any hard work. Already we start to imagine/dream about rich life style. At this stage our reasoning logic should be telling us "hang on, this looks too good to be true", but who cares about sensible reasoning here. It's all blocked by our greed. That devil in us starting to take control.



New Traders Loop

1

Then we discover all those wonderful indicators and oscillators. Magic...

"It looks so easy... Even using simple MA crosses can make a lot of money. I don't have to do anything. Just watch the crosses and enter". One thing, the deadly important aspect we overlook here is that these indicators are showing the past, not the present.

All indicators are lagging. I have not seen any working non-lagging or non-reprinting indicator to date. I suppose once time travel is invented it'll be possible to make non-lagging indicator.

2

When we discover the lagging aspect of these indicators we most likely will have some noticeable disappointment but at this stage we still are excited.

These wonderful indicators are much like a cheap hooker.

"That's fine" we say, "I'll go for classy expensive hookers". We imagine we can find a fine tuned, perfect indicator or system that produces winners consistently.. Then we start searching for that magical indicator or system, download and test many of them, try to fine tune them. buy some systems. enrol in some courses and so on.

3

Some of us end up wasting considerable amounts of money on these useless systems and courses. By the end of this stage most traders get wasted or give up on trading. On the other hand some decide to go back to the drawing board and re-start from scratch with the understanding that learning to trade may take a lot more time than they had anticipated at the start.

I'd like to make it clear that I am not against using certain indicators for information purposes such indicators that shows price, highs, lows and so on. The key is not to base your trading decisions on any indicator other than your main indicator: the chart itself and price upon it. Try not to pollute your charts with useless indicators until trading becomes your second nature. At this level it doesn't matter what indicators or how many of them are displayed on the chart; you'll ignore them and look for the prices and levels automatically, instinctively.

At least we can employ common sense

If you are new to trading, please do yourself a favour before buying any magic system or enrolling in paid courses, by asking these simple questions:

If these bullet proof black box systems are as good as their vendors claim to be, why are they selling it instead of using it for themselves? If I had such a magic system, I wouldn't sell it, at least not to the public. They'd be worth millions rather than this few hundreds bucks. I myself don't know the existence of any magic system that works so far.

If those mentors and teachers were so great, why don't they teach it for free? I don't buy the argument that they get greedy and want to make more money. Think about all the time and effort they put into those courses. Surely it could be utilized in trading, a much more rewarding career. However, I do buy the argument that some people are good at teaching but not so good at trading, so they are making their living from the greater talent. Nothing wrong with it. I only recommend to new traders choose carefully and choose the best ones if you don't want to end up wasting your time and money.

Risk

Out of the last group [Traders who went back to the drawing board rather than give up] only the ones who get to grips with a sound and disciplined risk management will survive.

In my view, the first thing to teach to a new trader is risk management. At least the importance of it.

A new trader may not take risk/money management seriously as he or she may be thinking "what the heck, I have only a 5K account and I know what's there. I know what is a loss and I know what's a win.. So what's to manage there..

I need to improve my entries first.. Money management will take care of itself as long as I have great entries". However, in reality, the first thing to be mastered is sound risk/money management.

Risk Comes From

NOt

Warren Buffett

Knowing

What You Are Doing

Warren Buffett put it short and sweet as to the source of a risk. Risk is heavily associated with uncertainty where we do not fully know the outcome of a certain situation.

Consider someone working on a complex project. He has a much harder task identifying and managing possible risks than a trader has. As traders we have a much simpler task when it comes to identifying the risk/s and managing them. There are only few variables we need to take into account. However, we have a harder task sticking to pre-defined discipline, due to the personal aspects of trading. Greed and Fear kick in and start messing with our psychology.

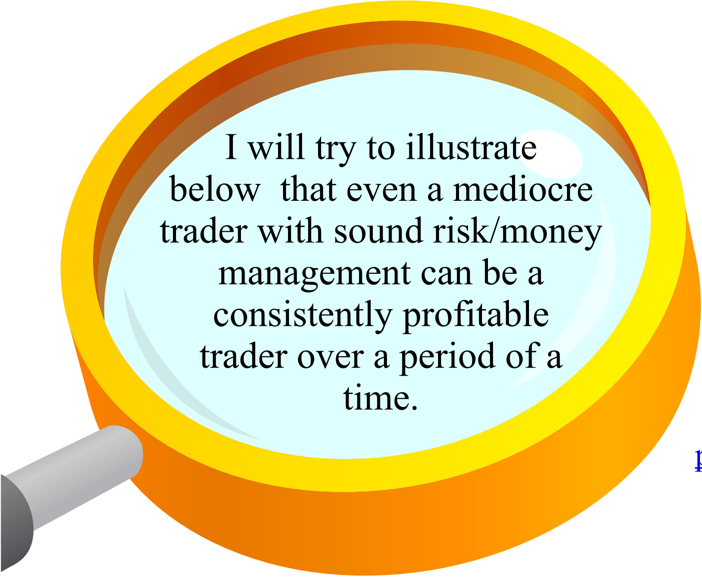
Trading psychology is the end product of how we manage our fear and greed within the framework of risk management.

The fear is our built in natural instinct. It rather serves us well if we are able to understand and use it properly. It's a self preservation mechanism. It warns us against possible dangerous items and situations. Unless, we are a formula 1 driver or don't care about our and others life, after accelerating over the certain speed we start feeling it.
How do we manage our fear? We use stop-loss. If we are not comfortable driving over 100 km per hour then once we hit our limit we slow down. Same rules applies to trading. We define in advance what's the maximum stop our account can handle and we stick to it.

The fear part is easier to understand and deal with. Fear originates from the unknown, the risk; we can manage to control it by avoiding stupidity and applying certain rules based on practical knowledge. On the other hand, greed is a totally different kind of beast. It's not so easy to control.

Ideal traders would be those that are bored, don't care about material things in this world and don't get on emotional roller coasters easily. Forget about Hollywood stuff. They are just movies.

You surely will be safer boarded on than standing in front of the Int. Express on tracks. Forget about the Hero stuff...



Lets say, you are a new trader and you just learned the basics of supply and demand zones/levels. Plus engulfing candle pattern. [See here for detailed explanation of engulfing candle pattern]. You can identify where to draw your supply and demand zones. If you find it difficult to spot the zones at first instances, then use SupDem indicator which draws it for you automatically. It's not perfect but it does the job.

I still use SupDem indicator. Why? Can't I spot them? Sure I can but there are certain situation when farther left zones are easily not visible unless you keep scrolling your chart. If the SupDem indicator doing it for me why should I do it manually?

As a new trader. I'd suggest you start trading on higher timeframe [HTFs] charts such as H4 or H1. Why is that? Is it easier to trade on HTFs charts? From a technical point of view there is no difference. You'll have the same price movement, and the same principles apply both higher and lower TFs.

The main difference is relative speed. There are other aspects, but that would be a subject of another article and not needed here. Even though, for better entry opportunities, looking at lower TFs is a good idea but let's leave that until we learn and understand overall price action and structure within zones better. This way you'll avoid immature panic and fear to a certain degree. That's all.

I was thinking to use simple illustrations but for the sake of realism and clarity lets use actual charts.

Most new traders will likely choose EUR/USD to trade, I'll also stick to it in this exercise. Once you learn to read charts properly after 1000s of hours of screen time, you'll come to understand the saying "Any pair, any time frame”.

The Risk Profile

Defining and creating your own Risk Profile one of the easiest task to to do yet it's the most important one

First we need to define our risk profile in line with our account size. Don't overlook THE RISK PROFILE. It's the heart of the matter. Extremely important.

If it doesn't make much sense at the beginning, take your time until you grasp the essence of it. Do it right... Do it wisely.

Never, Ever put your real money in any trading before you fully understand the risk management, and can define your very own RISK PROFILE.

Understanding and defining it is just the beginning. You MUST apply it to your trading with discipline as if your life depends on it.

What do we include **in Risk Profile**?

1. What levels of Risk:Reward [R:R] ratio will we be working with?
2. What's the maximum percentage of our account we are willing to risk on any one or more trade/s?
3. What's the maximum position size we can use?
4. In terms of pips value what's the maximum stop we'll be using?
5. Are we going to use break-even and trailing?
6. What time frame will we be trading?

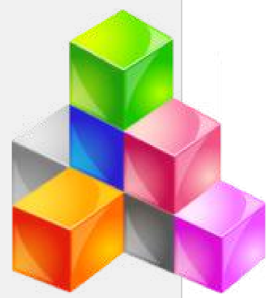
1

Minimum R:R [Risk:Reward] ratio we'll work with is 1 to 2. This means that for every pip we risk we want to gain 2 pips.

2

We don't want to live fast and die young and pretty. W**e will not risk more than 2%** of our account in any one or more trade/s. You may have come cross similar phrases before in books and articles. One thing is some of them don't make it very clear: Does 2% is applly to an individual trade? If so, can I open other trades simultaneously as long as I don't risk more that 2% of my account on any one of them? Of course not. Remember, we are talking about our total available account value, not the count of open trades at any one time. Depending on your account size, position size and stop value you may only be able to open one trade if the trade risk value is close or equal to 2% of your total available account value - available margin.

However, you can still open more than one trade even though when you open the first trade it's risk value may have been 2% of your available account value. How? Simply by locking your first trade when it's moving in your favour as long as you take into account spread and slippage. What this means is you have decent distance between your entry and current price so that you are able to move your stop at least break-even to +10/15 pips. Trade is locked and the risk is reduced almost to zero. Depending on your available margin you may be able to enter another trade.



An important point to remember is that markets can gap in either direction over the weekends. I'd strongly advise never leave such trades open over the weekend. As a beginner, I'd say do not leave even a single trade open over the weekend. Additionally, keep in mind that an unexpected big incident can cause gaps too, such as natural disasters etc. Unfortunately, we cannot do much about these.

3

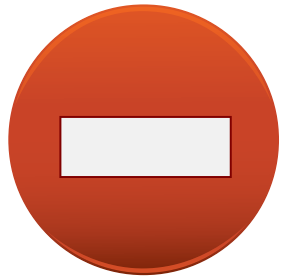
Position size we can use will depend on the account size. Even $5k will provide you with enough margin to trade a standard [std] lot if your broker gives 1:100 leverage. Using this kind of account setup and trading it with std lot will most likely kill your account in no time. In my opinion a suitable relationship between account size and position size as follows

- 100k+ for trading in std lots - 1 std lot [1.00] per pip value = $10
- 20k+ for trading in mini lots - 1 mini lot [0.10] per pip value = $1
- 5k+ for trading in micro lots - 1 micro lot [0.01] per pip value = $0.10

***Ps/.** Please note the above lots values refers to certain instruments such as EUR/USD with US$ as a the account base currency. Some other instruments have different lot values. While 1 standard lot value of EUR/USD pair is equal to US$10, 1 standard lot value of Silver is equal to US$50 currently.*

4

We will use a maximum of 40 pips stops. However, we will try to spot entry opportunities with less than 40 pips stops too but we will not take entries with more than 40 pips stop value. Therefore we'll be taking on trades that offers 80+ pips where entry required 40 pips stop [minimum 1:2 RR we already defined]. Well, how do we know if the entry offers minimum of twice the our stop value? Are we magicians or what? We of course don't know the outcome in advance, but supply and demand zones give us some idea. If we are buying in a demand zone with 40 pips stop and we see 45 pips above supply zone the most likely there is not enough room to get our minimum 80 pips.



Please understand that, not all offered possible rewards are realized at all times. Price may turn at any time against us before reaching our pre-defined target. This is where using break-even stops becomes handy. We shouldn't let a winning trade turning into a loser.

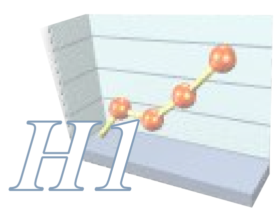
Ps/. *Under what to include in Risk profile, for the stops I used "Pips Value" rather than pips count. The reason for this as explained, while 40 pips value for EUR/USD would be US$ 400, for Silver it'd be equal to US$2000. Therefore we cannot use the same account [account size] for Silver trading in standard lots. We either have to increase our account size or decrease our position size when trading the Silver with same 40 pips stops.*

5

We will use break-even and Trailing. When price moves in our direction. Around 50% of our target we will move our stop to break-even. Please note, break-even means here; we will move our stop to entry price + spread. If the spread for the pair we are trading is 2 pips and our entry was at say 1.4225 then we'd be moving stop to 1.4227. If price is moving nicely in our direction, instead of closing the trade after it reaches our initial target of 2:1 we'll consider trailing it by moving our stop to initial target when price advanced further in our favor.

6

Let say we choose to trade the hourly chart as we are new and bit nervous. It's also important to decide on time-frame as our stops and position sizing will vary according to the time frame we decide to trade on. With higher time frames, we will need bigger stops and smaller positions depending on our available account value - available margin.



So, we have worked out our **Risk Profile** as follows:

- We will use minimum of 1:2 Risk Reward ratio
- We will not risk more than 2% of our total available account [available margin]
- As we have only 26k account we will only trade using mini lots as our maximum position size per trade
- We will work with maximum of 40 pips stops
- We will be using break-even and trailing as defined above.
- We will trade on hourly charts only.

As long as we can stick to the above risk profile defined, we can enter 10 trades, have 6 looser and only 4 winners but still end up with profit overall. No, this is not one of those too good to be true systems. It's a simple reality and can be proven with numbers.

For instance, say we used maximum of 40 pips stop for all 10 trades and used the minimum 1:2 reward to simplify the explanation here.
We had 6 loosing trades which translates into 6x40=240 pips loss
We had 4 winning trades which translates into 4x80=320 pips gain
So after 10 trades we have gained 80 pips overall

It's a simple fact but many new traders overlook such probabilities. It can do wonders for your trading psychology, especially if you are suffering in the hands of fear. However, for the above to work you must strictly follow the rules. The rules that you have defined yourself in your own risk profile. If you move your pre-defined stop against yourself, or exit trades before reaching the initial target it will fail miserably.

Please keep in mind, the above may vary in terms of trade count in reality. For example you may have 6 loosing, 2 break-even and 2 winning trades. In this case after 10 trades your account would be showing 80 pips loss. The point is, in certain circumstances it may take more than 10 trades to hit the plus as long as you do not panic and avoid doing silly things. We may also avoid such outcomes by taking trades when price is only in strong zones and ignoring weaker mid zones.

It's time to put the theory **Into Practice**

After all theory without a practical application is nothing more than some intellectual exercise. Unfortunately, an intellectual exercise itself doesn't put the bread on the table.

The Demonstartion - **Trade 1** (1/6)

Practice Trades

In the following practical demonstration of Risk Management, I have scrolled EUR/USD chart back to Oct 2010 as the starting point of this exercise. Chart contains only Chaos Semafor indicator for showing 3 levels of highs and lows. Purely for information not for our entry and exit decisions.

Time to get on with our 10 exercise trades.

We have one fresh supply zone and one demand zone. The fresh word here refers to zones are not been visited by price yet. Then we have some mid supply zones which we will ignore unless we see some decent opportunity. Now we wait and see what price does.

NB. I use an alert indicator which plays a sound when price is approaching wherever I place the alerter's horizontal line. I don't have to sit and watch the price on any particular chart. Please see end of this article for the indicators mentioned/used in this exercise.

Trade 1 (2/6)

See how price sliced through the first mid-weak zone. We cannot see any decent PA here to prompt us to sell, especially considering demand at bottom was established with an engulfing candle. So we ignore it.

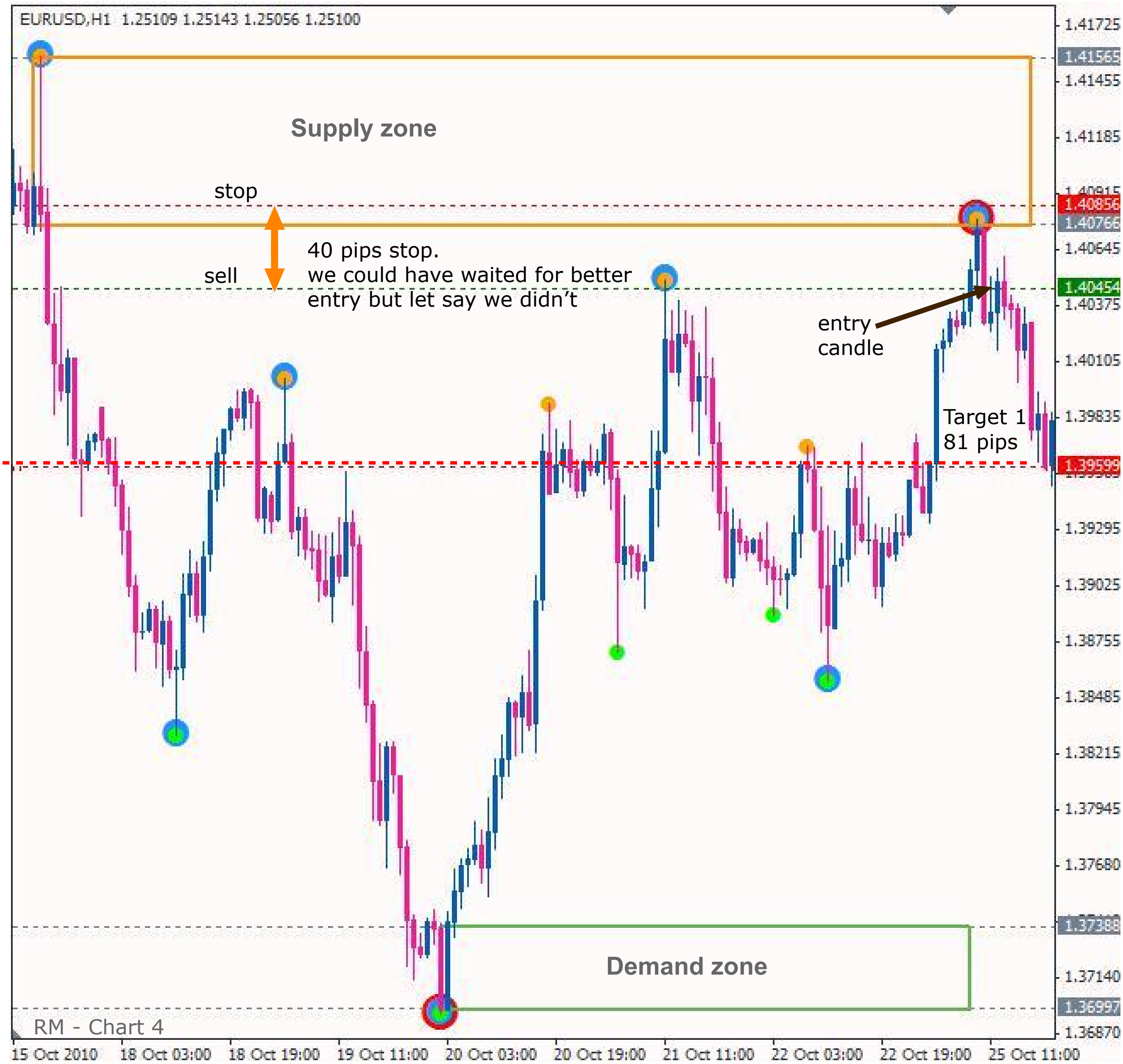
If upper supply works and price turns down towards demand then so be it. We'll wait for the next opportunity. Do not worry about missed opportunities. Markets present no ends of entry opportunities on a daily basis.

Trade 1 (3/6)

As expected all weak zones are taken out. After price touched the main supply zone we have been watching, it produced a juicy bear engulfing candle. Now we are looking for an entry opportunity that fits in with our Risk Profile. It comes first and second candle after the engulfing one. Since we are all excited and cannot wait we enter as soon as price hits our stop range. Now we have to wait and see without doing anything stupid in the meantime.

Please note that this entry doesn't fit conventional supply and demand trading. Textbook entry would have been when price traveled further up within supply zone so that we can have our 40 pips stop just outside [above the upper border] the supply zone. However, after price hitting supply zone then seeing such a nice engulfing bear bar we decided it's worth taking the risk and entered at first possible opportunity.

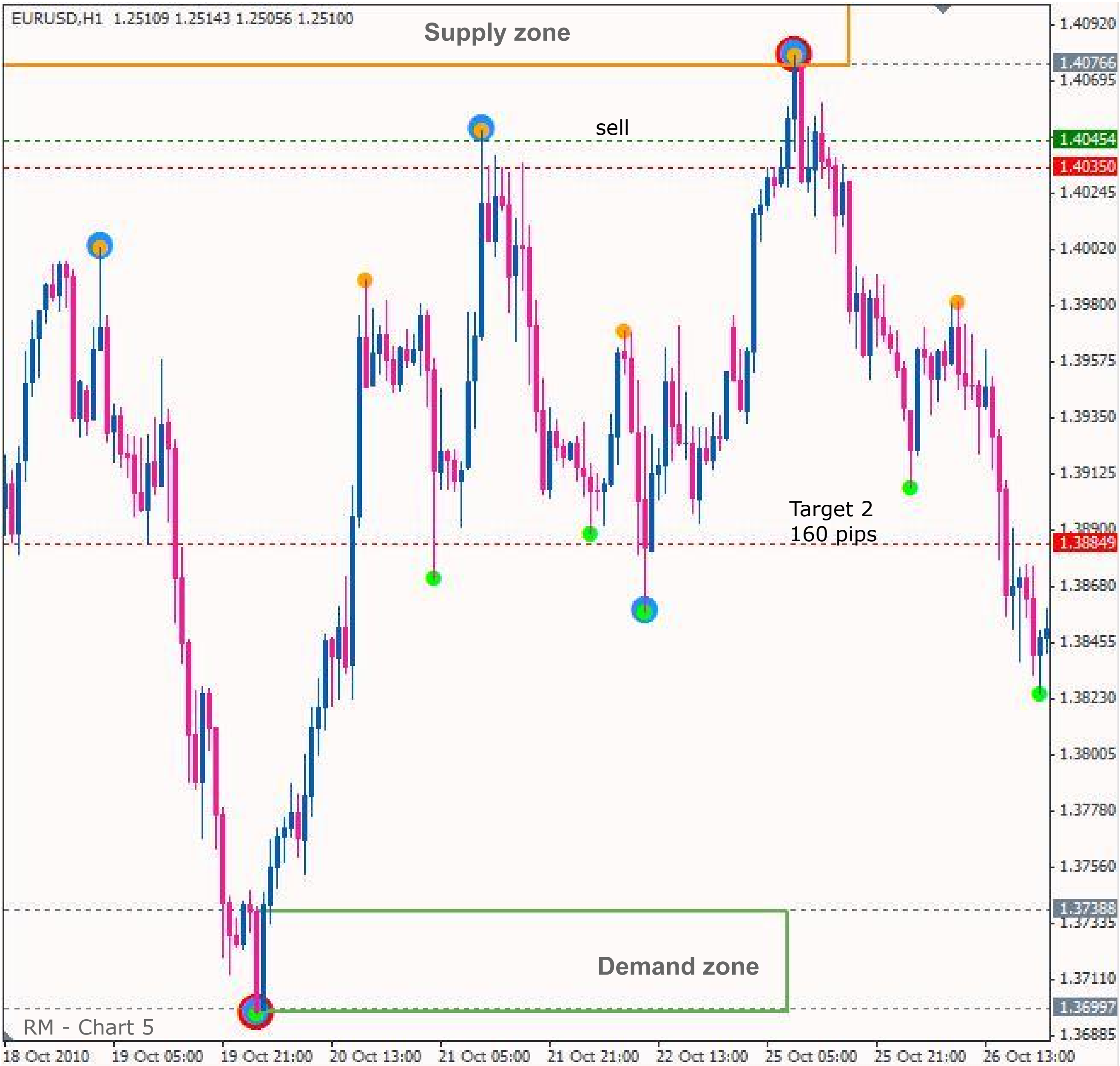
Trade 1 (4/6)



The price hit our first target. Decision time. Do we close or let it run? Obviously, we don't take a long time here to think about closing or not. We should already have a pretty good idea by now what we'd be doing when price hit the TG1.

We already know that best possible signal we hope to see on charts is a nice engulfing candle on right place. Meaning in and around strong zones. We have a nice engulfing and a decent PA. In this occasion we decide to move our stop break-even +, define TG2 and let it run.

Trade 1 (5/6)



Since price sliced through our TG2, we decide to move our stop to TG2 and let it run. Looking for the price to hit the bottom demand or at least come bit more close to it.

Trade 1 (6/6)

Trade 1 is closed with 290 pips gain.

We were proven to be right on this occasion. With patience and without unreasonable fear we have managed to maximize our gain by sensible trailing. We put our third and final target just off the demand zone to ensure quick exit. Often price can mess around before hitting the actual zone.

Some may ask why that bull engulfing candle pattern on the way down didn't work. Look at where it formed? Do you see any decent zone around there? Besides, we put off from our entry radar levels between the supply and demand zones we decided to trade.

Please note that not all price movement as straightforward as the above one. That's why it's very important that when we catch a nice opportunity we don't waste it with premature exits.

Trade 2 (1/4)

In accordance to our Risk Profile and dirt simple trading plan we take the buy in the demand zone. Our stop works out to be just outside of the demand zone.

There are various approaches on entries in and around supply and demand zones.

- Some enter when price hits the zone,
- Some wait and see if the the candle makes it into zone, closes inside the zone, or goes through therefore invalidate the zone.
- There are others who wait to see if price is going to be contained in the zone by watching PA to give them some clues.

In my case I do not subscribe to any particular one. I use all of them depending on the zone and how price travels, the speed price hits the zone.

Each approach has it's own ups and downs. Waiting for PA confirmation may take some time and it'll most likely will happen outside the zone thus increasing stop pips count. Of course it's still not guaranteed it'll work. On the other hand taking the trade when price hits the zone will reduce our stop pips count but we do not have any indication or clue if it'll be contained within the zone or not.

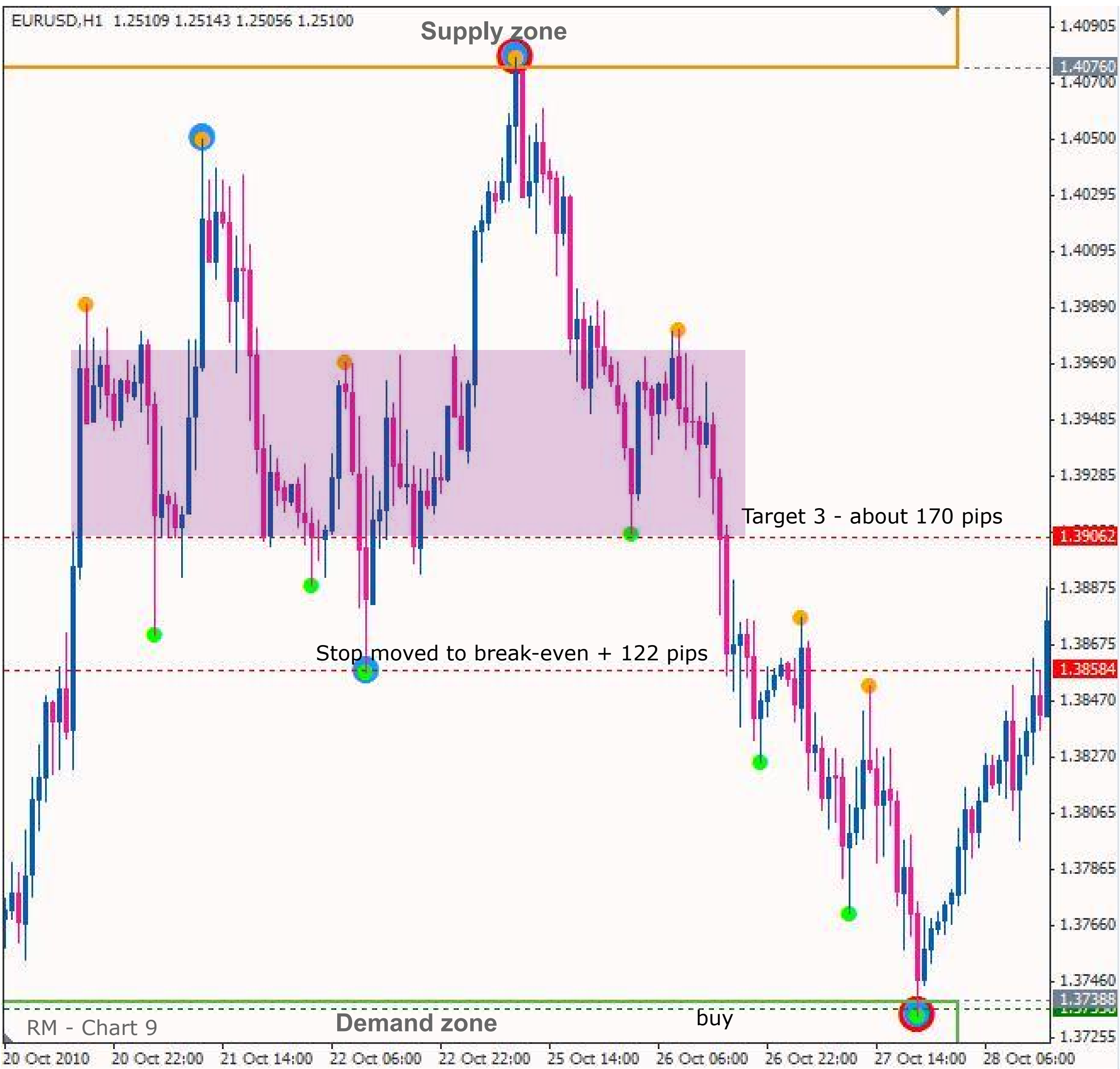
The above is a good example of for the first approach. We have a fresh fairly strong looking zone which is established with an engulfing bull candle and hitting the zone with fairly big H1 candle.

Trade 2 (2/4)

As you can see price hit our TG1 nicely. Instead of closing we expanded our TG to about from 80 pips to 120 pips and moved our stop to break-even + 19 pips. Our TG2 is almost hit but not quite. Since we moved BE to plus 19 pips we can afford to wait and see.

All looking good so far. We locked our trade. We are fairly safe. We won't be taking any loss on this trade unless something unexpected happens or we leave this trade like this over the weekend and market gaps down to well below our entry price.

Trade 2 (3/4)



TG2 also hit with a nice big bull candle. Instead of closing we decided to trail. Moved TG further up and moved our stop to break-even + 122 pips.

We could have moved our TG further up but notice the left boxed dirty price action zone. We don't want to get involved in any dirty price action. It's best to take what we have [once hit the dirty zone] and run. If TG3 hit we'd be achieving over 4:1 reward ratio. No point getting greedy. If it slices through the dirty zone so be it. We'll wait for the next opportunity.

As this trade is fairly secured, we may go ahead and look for another trading opportunity on another instrument.

Trade 2 (4/4)

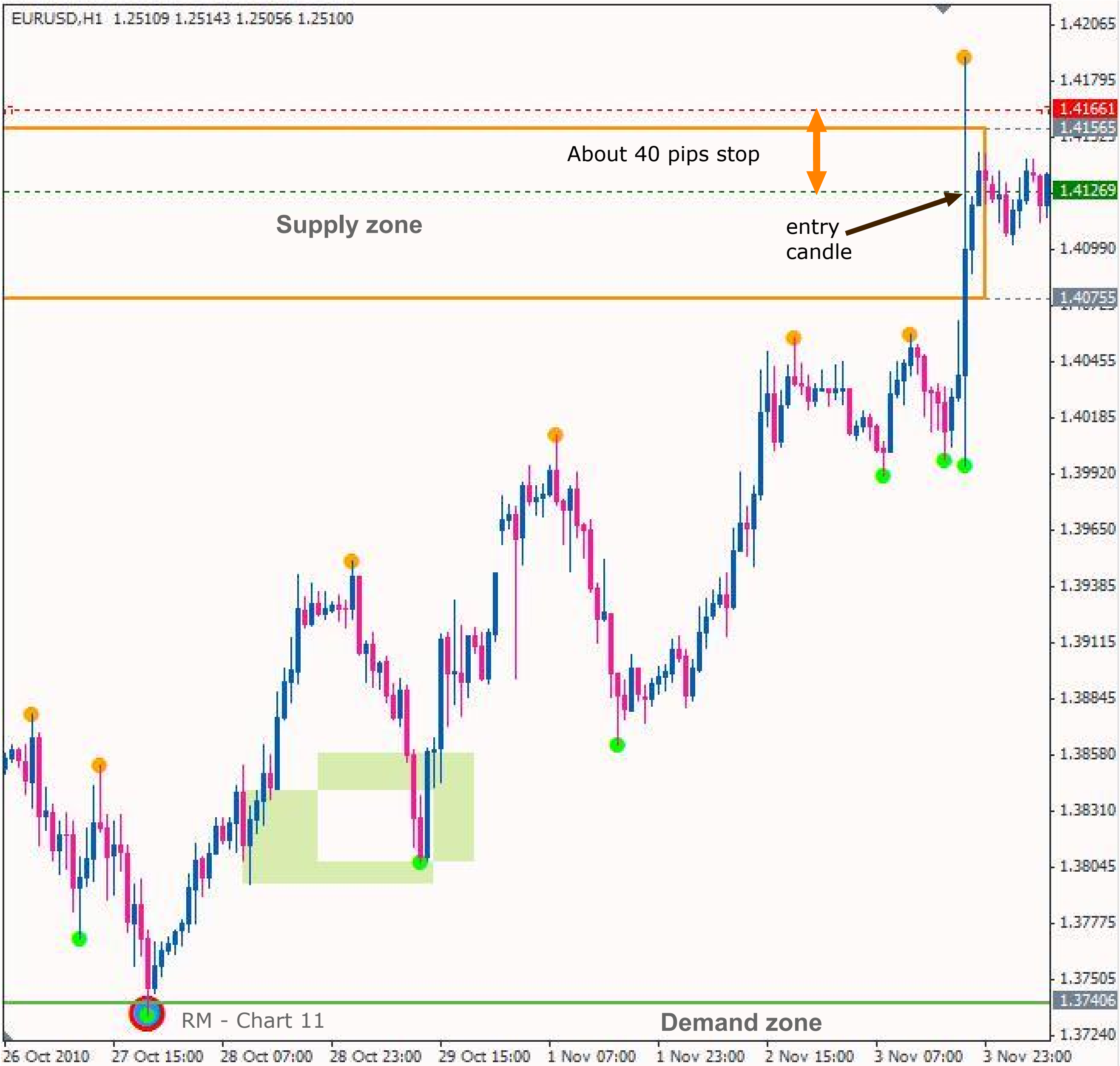
Trade 2 is closed with 170 pips gain.

What about that current bull engulfing candle then. Are we not going to trade it? Yes we would consider this buy after a good engulfing bull bar around previous spike.

Additionally, price has been bounced from fresh demand and not reached any serious supply yet. However, we cannot take this buy trade as stop would be bigger than our Risk Profile allows us.

We need to wait for the next candle and see if it's going to come to within our 40 pips range.

Trade 3 (1/1)

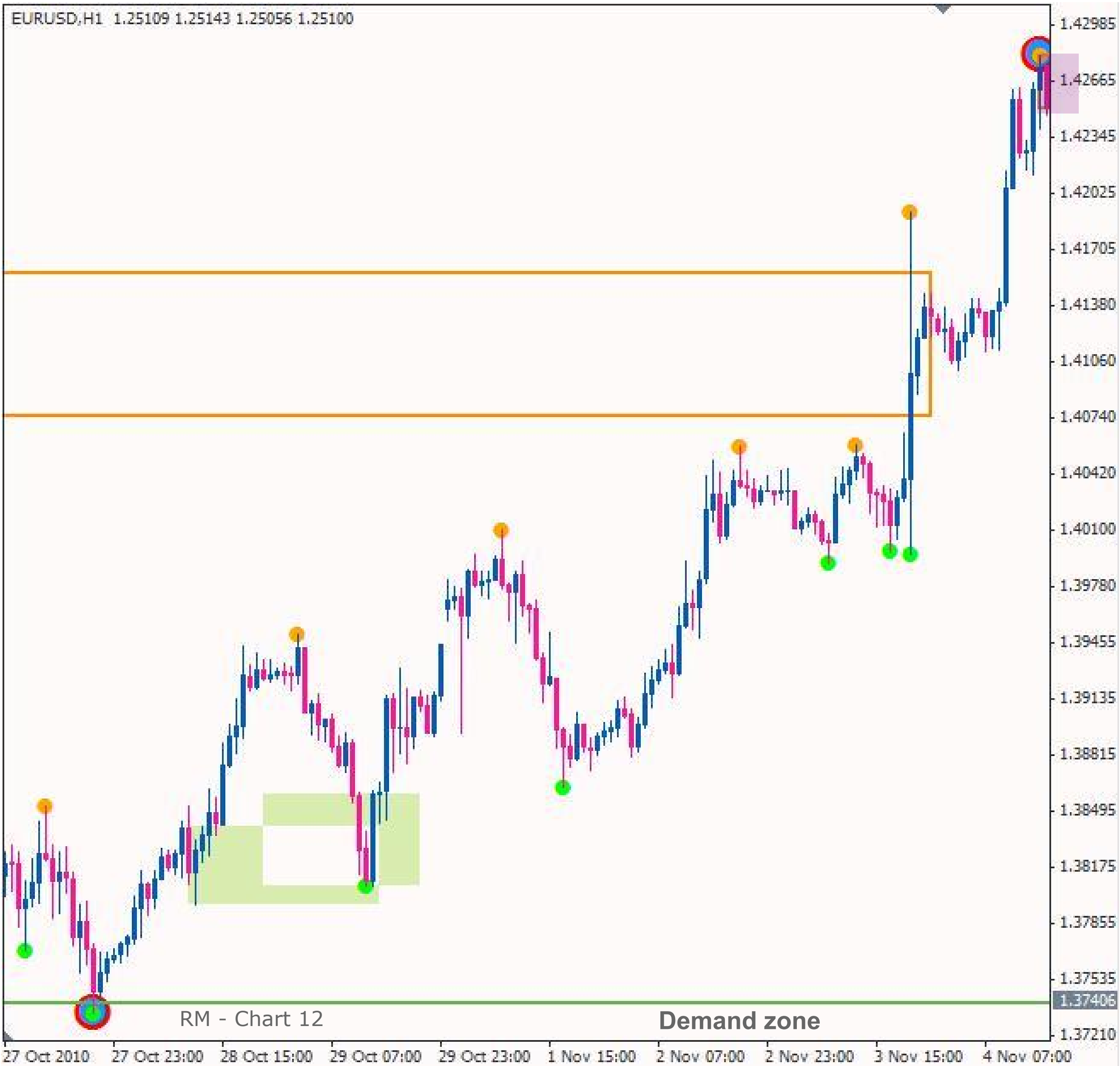


Unfortunately, price didn't come down enough to allow us enter with a maximum 40 pips stop as defined in our Risk profile in fresh demand zone.

However, we took a sell order in fresh supply zone without waiting candle finish or PA config.

All was good other than amount of time price took to reach supply zone.

Trade 4 (1/5)

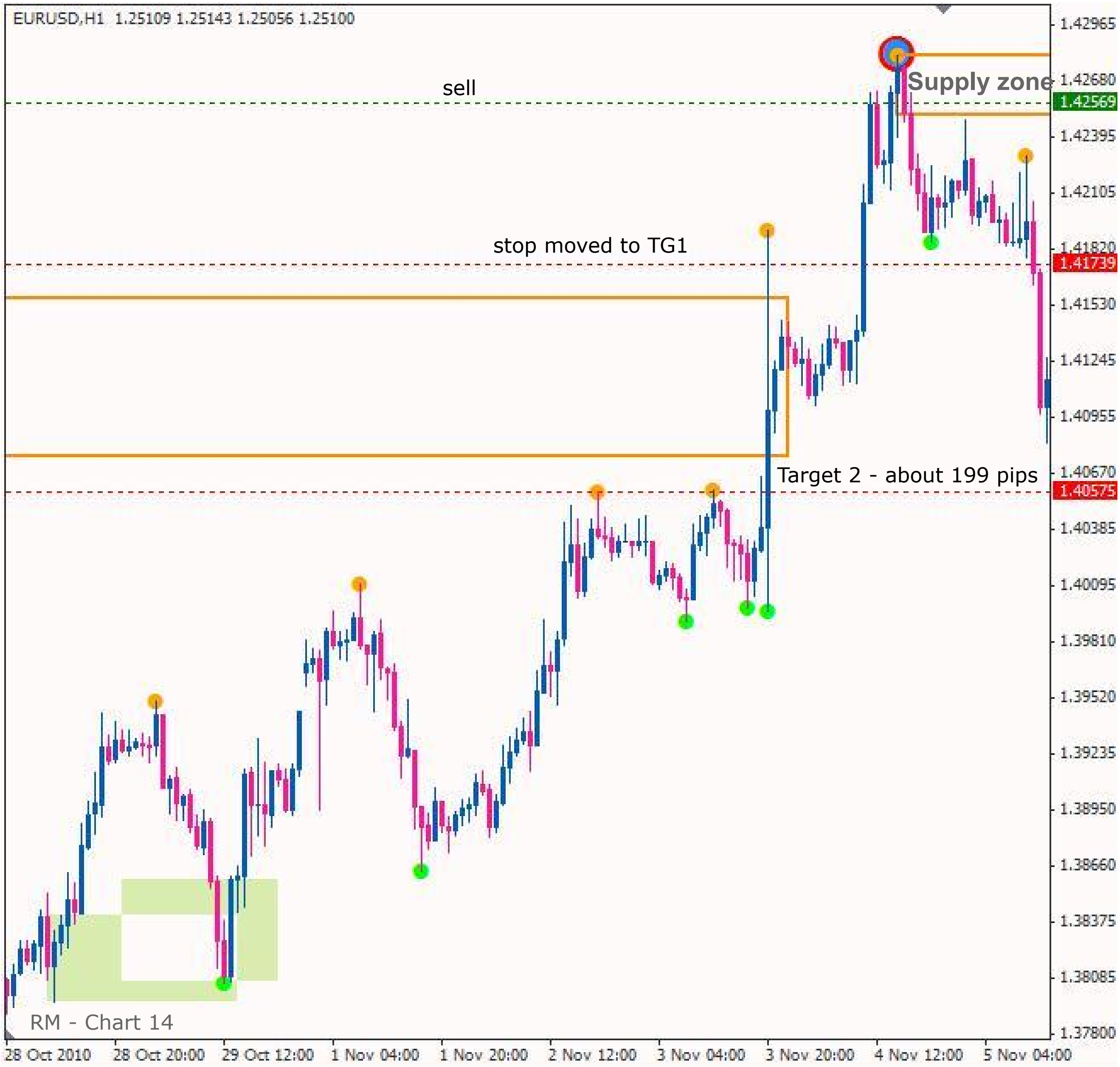


A new zone established at new high with an bear engulfing candle. If the risk is small, newly established zone looks attractive, looks a worth try. We will have to wait and see what kind of risk level it'll offer on the next candle.

Trade 4 (2/5)

We have our entry with bit lower than our maximum stop of 40 pips

Trade 4 (3/5)



Instead of closing we decided to trail as the candle following the one hit the target worked out nicely. So, we moved the stop to TG1. Locked our 80 pips gain and moved the TG further down.

Trade 4 (4/5)

Again instead of closing we decided to trail. Selling pressure looks quite promising. Already sliced through a minor ranging zone and gunned into bigger one. Decided to go for the full monty by moving target all the way down. However, this doesn't mean we will not keep trailing at reasonable distance.

Trade 4 (5/5)

Trade 4 is closed with 405 pips gain.

Are we going to buy here? Not as yet. It's a weak demand zone and we don't see any convincing PA as yet. So, we wait and see.

Trade 5 (1/3)

Now we have our bull engulfing candle. Only downside is it's on a weak zone. We can not take the entry as yet. Price is well out of our stop range. We'll have to wait and see if price will come down within our stop range.

Trade 5 (2/3)

Even though current H1 down-trend, PA and levels have some warning signs for buyers we went ahead and bought it. Managed to reduce stop size to 27 pips. Sometimes we like to go against all odds. It's just part of our self destructive psychology. Commonly known as devil in us.

Trade 5 (3/3)

Stop is hit

On Sidelines

Since the lower demand was not fresh we decided to wait and see the finish of the big bear candle. Eventually, it took out lower demand. Established new supply zone and selling pressure is still on.

Trade 6 (1/3)

Even though it's a minor supply we take the sell trade almost within the zone. We could have sold bit higher and therefore reduce our stop amount but we wanted a bit of PA confirmation. A weak but some indication that sell is still on. We had better indication as to where price may be heading on the near left. Note those big engulfing bear candles within/around the supply zone.

Some call it previous demand zone turned into supply zone. That's a bit too techie for me. The fact is that sellers are in charge as we can see on the chart. Buyers from the origin of the demand zone already used their buying power and remaining ones are wasted at subsequent visit.

Additionally, worth noting that we see on the charts new lower highs and two demand zones are taken out without much difficulty. Especially the lower main one taken out with such a zeal that we need to take notice of heavy selling pressure. What this means is that selling the peaks may be better option than buying in minor demand zones.

Trade 6 (2/3)

When TG1 is hit, we moved our stop BE+9 and TG2 to 118 pips. We let it run; trusting our analysis about heavy selling. We could have taken well over 120 pips with further trailing but let it run and it's almost hitting our stop. At this point some of us may start to panic and close the trade while hitting our head against the wall for not taking at least 118 pips.

In my case, I'd let it to hit my stop rather than closing here, since I decided to trail beyond 118 pips, current price would be worst place to close. I have already overlooked 118+ pips. It would be silly of me to close here for the sake of few pips. I already moved my stop BE+ so it won't be a losing trade unless extraordinary events occur.. why panic?

Trade 6 (3/3)

Trade 6 is closed with 209 pips gain.

On this occasion we got back previous low, but sometimes price takes the stop by a couple of pips or so. For those who cannot handle frustration when such thing happens best to trail more closely or close the position when TG1 is reached.

Since it took out previous low, wouldn't it be better to trail further? Sure, we could have tried that but kept our original target at this time. That's all.

Trade 7 (1/4)

Why we took this long entry when we were convinced there are heavy sellers and were saying best to sell peaks.

Price created a form of gap and hit the rejection point. This knowledge may be out of the beginner's domain.

So, lets just say we see heavy selling up to a certain point then rejection. Since it fits to our stop range we want to try this newly established zone.

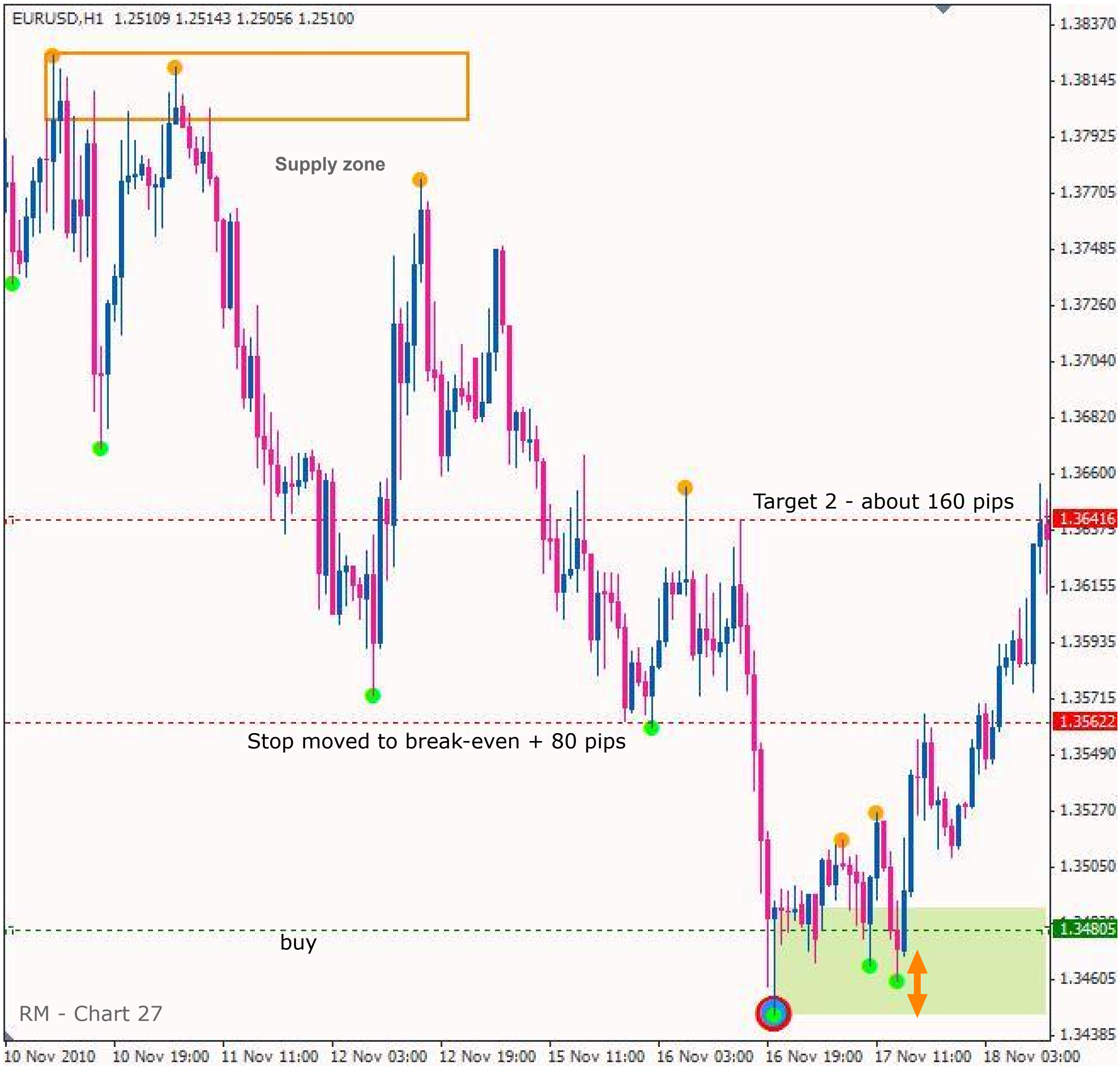
Trade 7 (2/4)

Just short of our TG1. It looks turning against us. We don't want the winning trade to turn into a looser so we moved stop to BE+10

Trade 7 (3/4)

Since we have a nice bull candle it would be shame to close here rather than trailing. So we move the stop to TG1 and TG expanded to TG2 for 160 pips.

Trade 7 (4/4)



TG2 is hit and decided to close due to price structure on the left.

Price continued to travel in our direction after bit of dip. We don't worry about pips left on the table at this point. We are just following our simple rules and what we can see on the chart. Once you gain enough experience you may be able to extract a lot of pips. Remember, Rome is not built in one day.

Trade 8 (1/7)

Since we already have a supply zone just above, we have decided to go with the newly established supply zone just below the existing one.

Note: *Conventional supply and demand trading method advises us to wait for the price to visit the established zone before entering the trade. The reason for this is that establishing zone usually takes more than a couple of candle. However, in this exercise we have been taking trades just after a zone created. We go in early if we see attractive PA when establishing a zone. And of course we always keep left of the chart under constant observation. We look at left and trade the right.*

Trade 8 (2/7)

Trade is developing nicely. TG1 is hit. Instead of close we have moved stop to BE+29 pips and expanded the target all the way down to near demand. Now we are targeting just over 250 pips. It would be real nice if we get it. That would be over 1:6 reward ratio.

Trade 8 (3/7)

What the heck.. Since price moving nicely in our direction we have the opportunity to move stop to our TG2 and let it run. Heavy selling pressure. We know overall market direction is south [down]. The downside is if it turns from here we'd be loosing a buy entry in demand zone.

Trade 8 (4/7)

Demand is taken out with ease. We have locked 1:7 reward ratio by moving our stop bit further down. Now we can sit and relax. Let the price do it's thing. See what else it may offer. At this point it doesn't matter a bit if it turns and hit our stop. If it doesn't then we may be onto something bigger here. However, we will still trail it at a reasonable distance.

Trade 8 (5/7)

Run is still on. We have no rush to exit. We just have to keep our greed in check here and let the price do it's thing. After all we don't catch such moves every day.

Trade 8 (6/7)

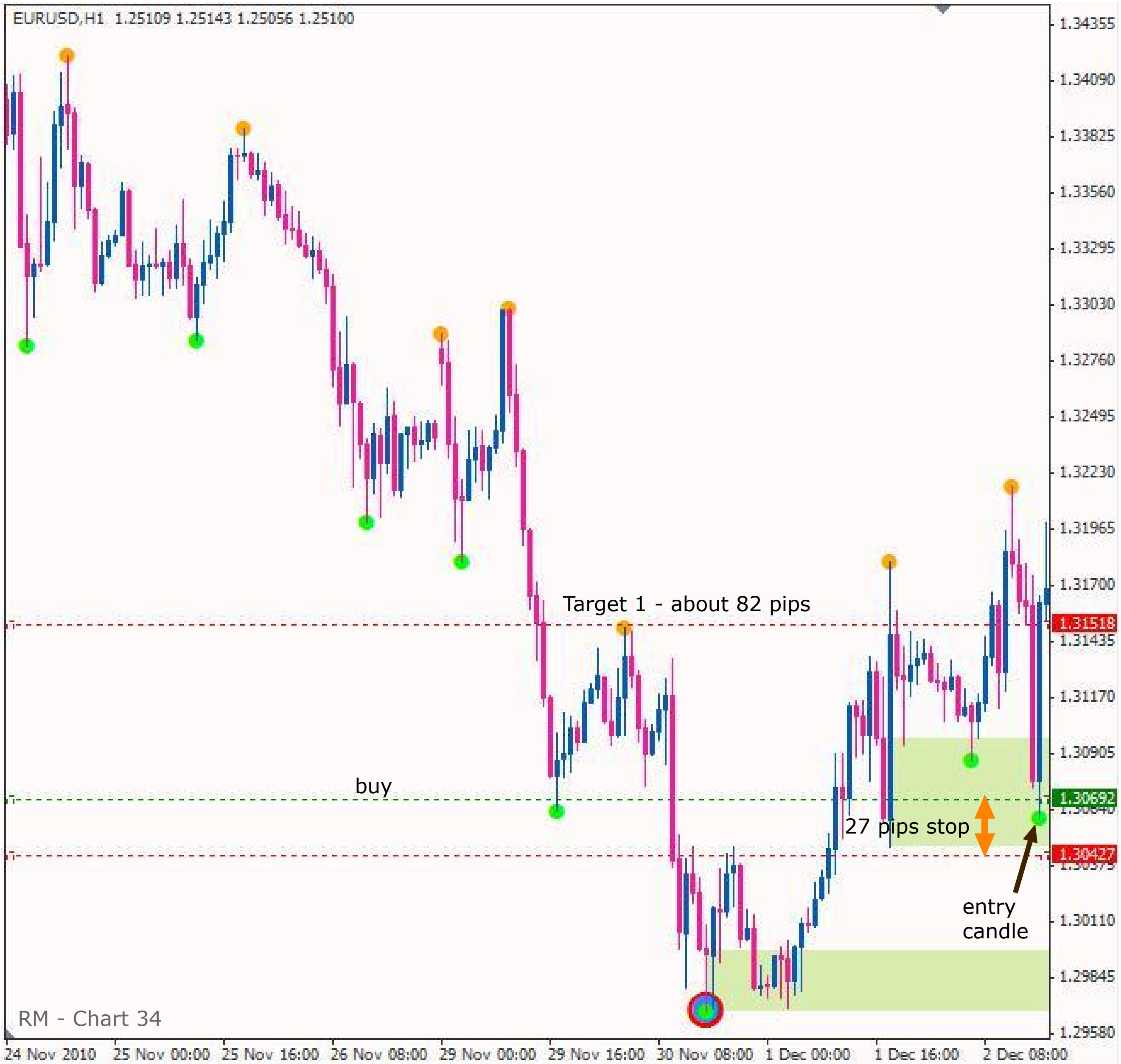
Traders with enough screen time will know that once price hits an important psychological level it's bound to react. We are trading EUR/USD and it hit sub 1.30. Lets assume we are new and not familiar with such stuff. So we leave our trailing as it's at 652 pips.

Trade 8 (7/7)

As expected bounced from new territories of 1.29. Our stop is hit. However, it took bit of time but was a nice runner.

With this trade we can understand bit better benefits of using sensible trailing.

Trade 9 (1/4)

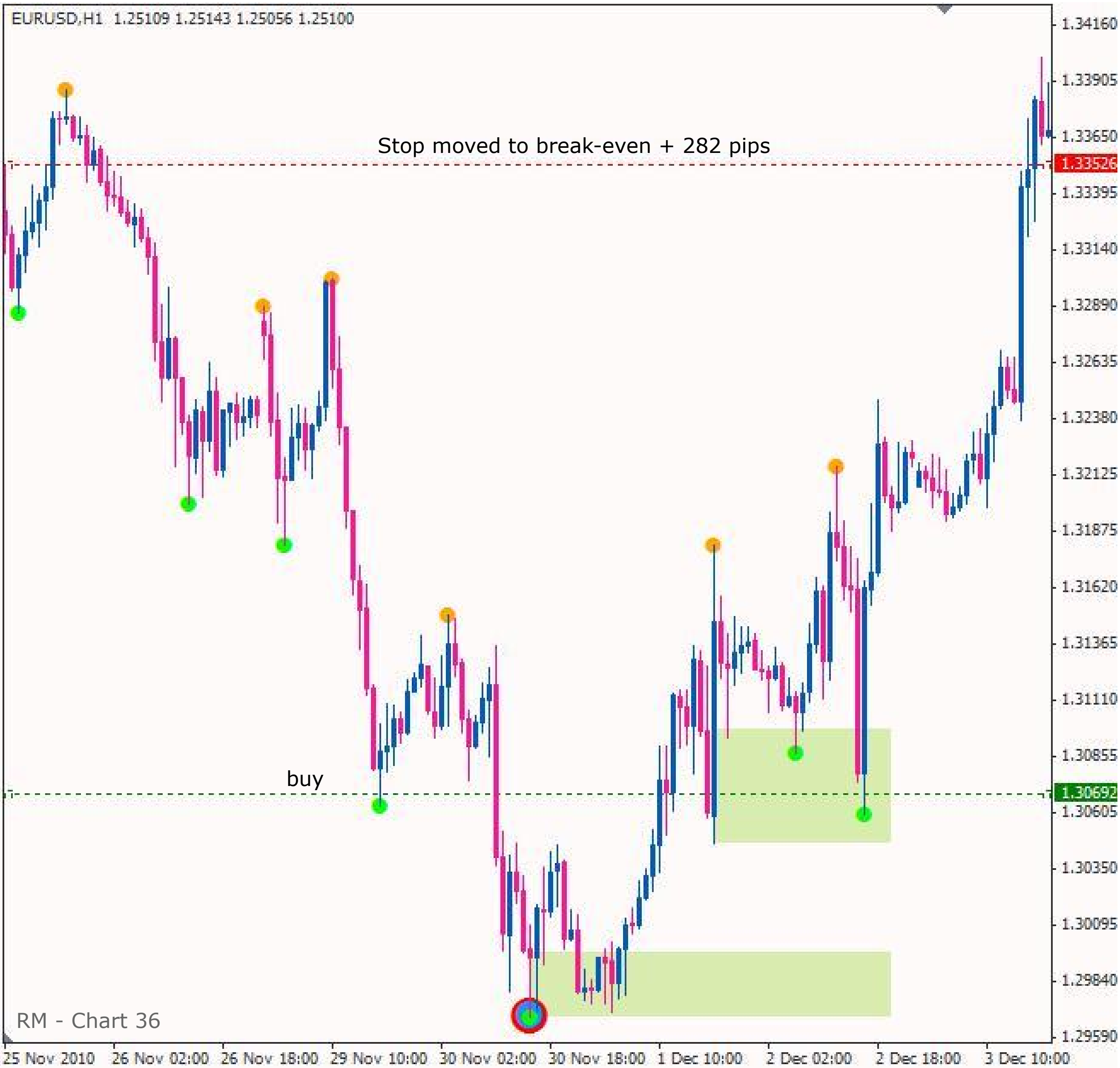


We have missed the lower demand while waiting for our previous trade. Decided to enter a long on upper demand. Couldn't take previous hits as it was not in range of our stop. As you can see our initial TG is already hit. Not closing it. Moving stop to BE+ and expanding the TG.

Trade 9 (2/4)

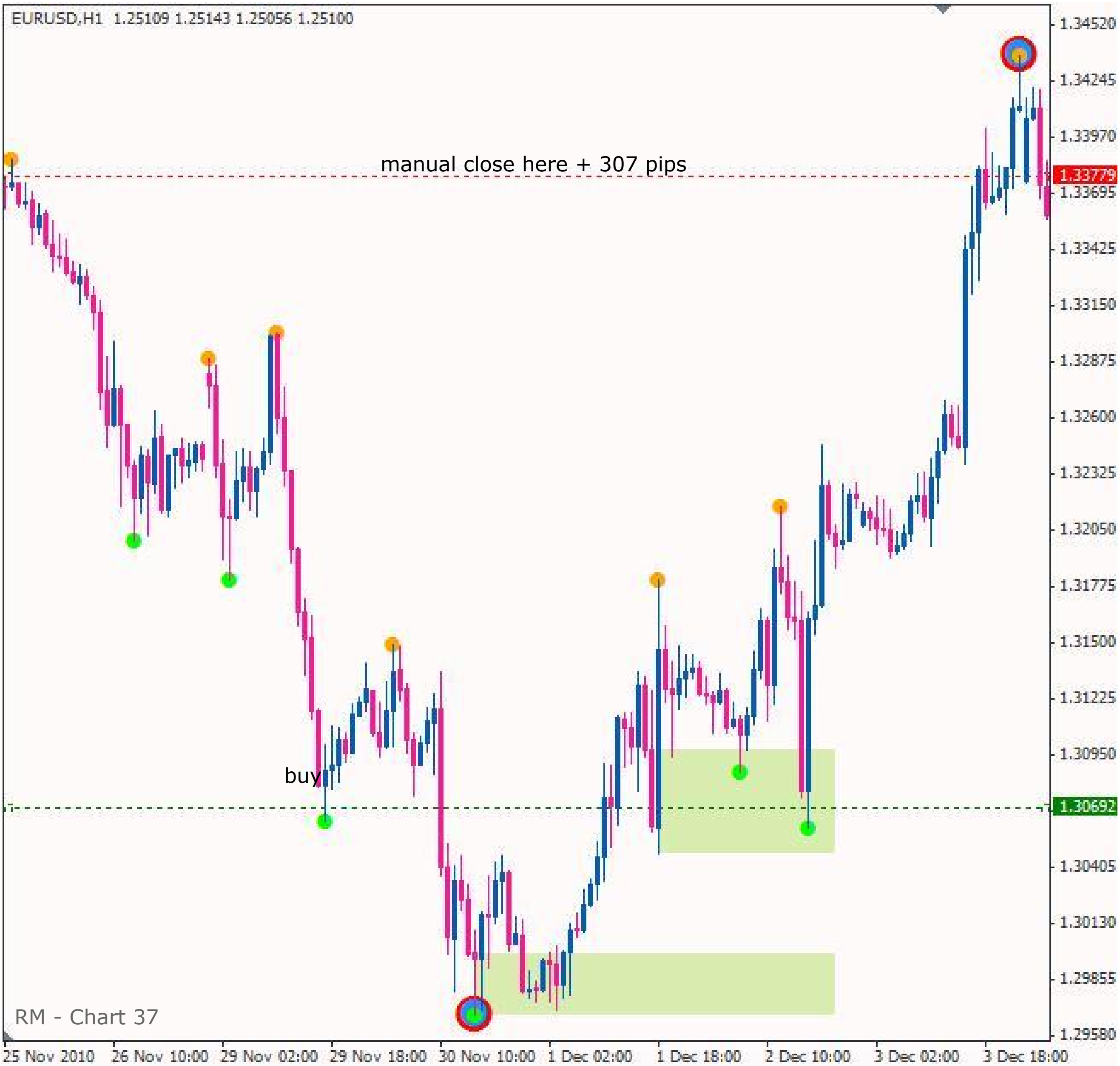
We will start trailing here as we don't want to give back most of our gains.

Trade 9 (3/4)



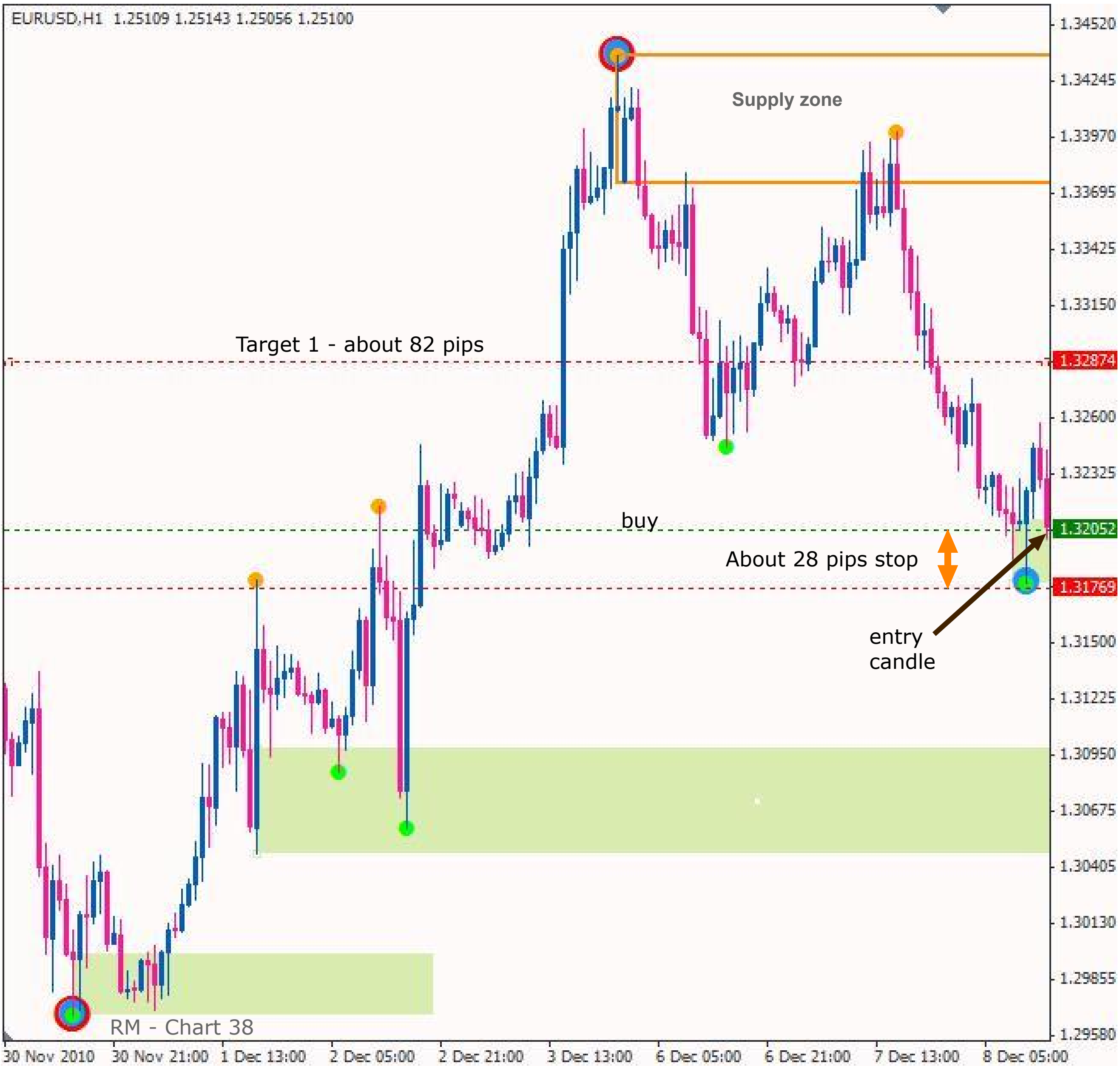
Since it took out previous highs we keep trailing it. Already secured about 282 pips. Let see if market is willing to give us more.

Trade 9 (4/4)



Closed here manually after seeing rejection and especially engulfing bear candle.

Trade 10 (1/3)



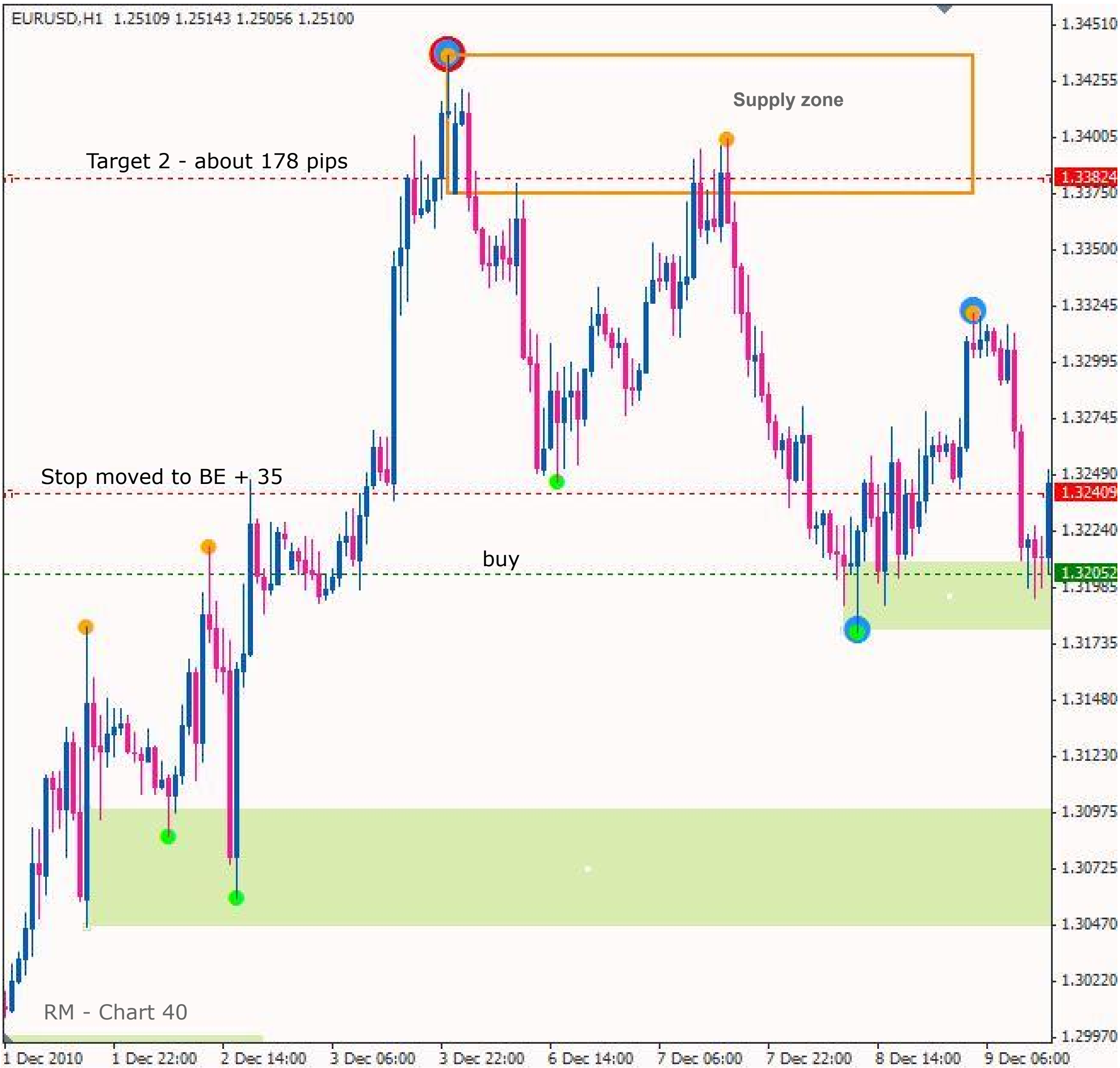
We couldn't take the sell order as it was just outside our stop range by 1 or 2 pips. We just cannot say what's 1 or 2 pips. We could take that sell. Look how it worked fine. Yes, but we cannot compromise on our Risk profile. Once it's defined we must keep it's rules to the pips, until we decide to work out a new one. We just cannot work out a new Risk Profile to fit in our current trade. So best is too keep it if it's working until it doesn't over a period of time. Discipline must be there at all times.

We enter a buy order in newly established demand zone with smaller stop than our maximum.

Trade 10 (2/3)

Initial TG is hit. Again instead of close we started to trail by moving stop BE+35 and expanding the TG.

Trade 10 (3/3)



Trade 10 is closed with 35 pips gain.

Unfortunately, on this occasion price didn't go in our direction. It hit our stop.

Taking Stock of our exercise trades

Now that we have finished our 10 trades, lets have a look our pips and time inventory.

Started on 15 Oct 2010
Fished on 9 Dec 2010
Nearly 2 Calendar Months

- Trade 1 is closed with 290 pips gain
- Trade 2 closed with 170 pips gain
- Trade 3 closed with 40 pips loss
- Trade 4 closed with 405 pips gain
- Trade 5 is closed with 27 pips loss
- Trade 6 closed with 209 pips gain
- Trade 7 closed with 160 pips gain
- Trade 8 is closed with 652 pips gain
- Trade 9 closed with 307 pips gain
- Trade 10 is closed with 35 pips gain

Gained pips count: 2228
Lost pips count: 67

Balance 2161 +

We took only 10 trades in the period of almost 2 calendar month and come out with 2161 pips gain. That's about 1080 pips per month and 54 pips per day for 20 trading days in a month.

Most importantly we have achieved over 1:5 risk reward ratio.

This results is based on 1 instrument traded. We could have been trading multiple instruments and results may have been different in either way. I kept it to 1 pair to save myself capturing a lot of charts and writing more.

Last few words...

I have tried to demonstrate the importance of a Risk Management and its implications. Along the way I have added further information on other aspects of trading as and when appropriate beside risk management.

As long as we can define a sensible Risk Profile for ourselves and strictly adhere to it, we are more than halfway there.. To be a consistent profitable trader.

"Let winners run and cut losers quickly" may be considered as a cliche by some but it's a golden one. I have also tried to demonstrate the power of this cliche.

Welcome to Holly Grail of Trading.

Ken - Ace Gazette
http://www.acegazette.com/

P/s. Here are the info indicators used/mentioned in this article, archived as a zip file. They can be downloaded freely from here - The download link near the bottom of the page.

Indicators included in this archive file are:
-Chaos Semafor
-IISupDem [Slightly modified to omit not needed parts to keep screen cleaner. Two version included. Both are same, only difference one for dark and other of light background charts]
-Horizontal Line Alert