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11 YEARS ANNIVERSARY

Money & Risk Management

Protection Against Piranha Attacks: The 6% Rule

By Joseph Barrington-Lew and Dr Alexander Elder

Money and Risk Management are absolutely vital for successful long term survival and profitability in the market.

Joseph Barrington-Lew is the creator of the popular JBL Risk Manager software and has written several in-depth articles for this Report over the years on this crucial topic.

The following article was previously published in our weekly Report. In it, Joseph shows how part of his software may be used to monitor Dr Alexander Elder's 6% *'Piranha Protection'* Rule. At the end of this article is a link which allows you to take a Free Trial of Joseph's JBL Risk Manager.

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The 6% Rule

During past stock market booms, limiting Risk was often ignored, or treated as an afterthought. For many traders and investors around the world, the crash of 2008 and 2009 have very seriously brought home the harsh realities of losing money in the market and the need to get serious about protecting capital and profits next time around.

In his excellent book '*Come Into My Trading Room'* Dr. Alexander Elder introduced the 6% Rule such that;

" ...whenever the value of your account dips 6% below its closing value at the end of last month, stop trading for the rest of the month."

Elder says;

"A trader keeps sharks at bay with the 2% Rule, but he still needs protection from the piranhas. The 6% Rule will save you from being nibbled to death……The 2% Rule will save you from a disastrous loss, while the 6% Rule will save you from a series of losses. The 6% Rule forces you to do something most people cannot do on their own – stop losing streaks….

………. The 6% Rule protects you from the piranhas. When they start biting you, get out of the water and do not let the nasty fish nibble you to death. You may have more than 3 positions at once if you risk less than 2% per trade. If you risk only 1% of your account equity, you may have open 6 positions before maxing out at the 6% limit.

The 6% Rule protects your equity, based on last month's closing value and not taking into account any additional profits you have made this month.

If you come into a new month with a big open profit, you have to recalibrate your stops and sizes so that no more than 2% of your new total equity value is exposed to risk on any given trade and no more than 6% on all open trades combined.

Whenever you do well and the value of your account rises by the end of the month, the 6% Rule will allow you to trade a bigger size the following month. If you do poorly and the size of your account shrinks, it will reduce your trading size the next month.

> The 6% Rule encourages you to increase your size when you're on a winning streak and stop trading early in a losing streak. If the market moves in your favour, you will move your stops beyond breakeven and put on more positions.
>
> If your stocks or futures start going against you and hitting stops, you will lose your maximum permitted amount for the month and stop, saving the bulk of your account to trade the next month......."

(Note: This Rule is not part of Jim's own trading but is included here for Members' information)

Recap: The JBL Risk Manager

The JBL Risk Manager is a simple but Professional Money Risk Management program which automatically calculates your:

- Trade Size
- Stop Loss price
- Break-even price
- Trailing Stop
- and much more, based on the last close.

Alternatively, you can also enter a "*Technical Stop*" (e.g as selected using Jim Berg's methods) in the *'Enter Stop'* Column.

JBL Risk Manager calculates your Profit / Loss automatically and updates daily.

Total Brokerage: $311.03 (closed trades only)	**Total Gain/Loss (R):** 1.41	**Standard Deviation:** 0.63
	Average Expectancy (R): 0.70	**System Quality Number:** 1.58
Capital: $105094.048 ▲ $5094.048 5.09%		
Cash: $48991.575		
Portfolio Comparison: ▼ -7.31% [Compare]	Symbol: XAO ▲ 12.40%	Since First Order: 2/03/2009

The latest version also displays Van Tharp proprietary performance indicators automatically.

Money - Risk Management [RTC]

Capital Above	Max % Risk / Trade	Trade Size %
0	2	19
50001	2	19
100001	2	19
150001	1	6

Brokerage - Long Trades

Trade Size Above	$ Brokerage	% Brokerage
0	32.95	
15000		0.4
55000		0.35
1000000		0.13

The Maximum Risk / Trade is set by the trader, e.g. 2% in *'Settings'* when the Portfolio is first opened. It will also allow for brokerage both ways, often forgotten by many traders and investors.

Elder's 6% Example

In his book *'Come into My Trading Room',* Dr Elder gives the following Example:

"……..For simplicity's sake, let us assume we'll risk 2% of equity on any given trade, even though in reality we try to risk less.

At the end of the month, a trader calculates his equity and finds that he has $100,000 and no open positions. He writes down his maximum risk levels for the month ahead: 2% or $2,000 per trade and 6% or $6,000 for the account as a whole.

Several days later the trader sees a very attractive Stock **A**, figures out where to put his stop and buys a position that puts $2,000, or 2%, of his equity at risk……"

Initial Stop Loss %	2	Breakeven	35.024	Technical Stop	
Maximum Risk	2000.00	Days Held		**Initial Stop**	31.394

"….A few days later he sees Stock **B** and puts on a similar trade, risking another $2,000 (approx.)..”

Initial Stop Loss %	2	Breakeven	17.146	Technical Stop	
Maximum Risk	1960.707	Days Held		Initial Stop	15.358

{Unlike the first trade we now no longer have $100,000 in available Trading Capital. The JBL Risk Manager now bases our Trading Capital on available cash + $value of any open trade(s) if stop were hit.}

"….By the end of the week he sees Stock **C** and puts on a similar trade, risking another $2,000 (approx.)…..”

Initial Stop Loss %	2	Breakeven	20.654	Technical Stop	
Maximum Risk	1921.87	Days Held		Initial Stop	18.499

{Again, Trade Size, Stop Loss (allowing for brokerage) and breakeven price are all automatically calculated and Trading Capital is based on available cash + $ value of any open trade(s) if stop were hit.}

"…..The next week he sees Stock **D**, which is more attractive than any of the three above. Should he buy it? **NO**, because his account is already exposed to 6% risk.
He has 3 open trades, risking 2% on each & he may lose 6% if the market goes against him. The 6% Rule prohibits him from risking any more at this time….”

Open Trades

Symbol	Trade	Sector	%Risk	SR	INITIAL Order
C	Long	BANK	2	▼	$20.49 x 887 + $72.699 = $18247.329 on 24/04
B	Long	BANK	2	▼	$17.01 x 1090 + $74.164 = $18615.064 on 20/0
A	Long	BANK	2	▼	$34.74 x 544 + $76 = $18974.56 on 16/04/2009

*{Seen here in Trading Summary page, red arrows indicate trailing stops of all 3 are **NOT** above their Breakeven prices and 6% of your Trading Capital is currently at risk.}*

"…. A few days later, Stock **A** rallies and the trader moves his stop above breakeven. Stock **D**, which he was not allowed to trade just a few days ago, still looks very attractive. May he buy it now?....”

Open Trades

Symbol	Trade	Sector	%Risk	SR	INITIAL Order
C	Long	BANK	2	▼	$20.49 x 887 + $72.699 = $18247.329 on 24/04/
B	Long	BANK	2	▼	$17.01 x 1090 + $74.164 = $18615.064 on 20/0
A	Long	BANK	2	▲	$34 x 544 + $76 = $18572 on 1/04/2009

"**… YES**, he may because his current risk is only 4% of his account. He is risking 2% in Stock **B** and another 2% in Stock **C**, but nothing in Stock **A** because his stop is above breakeven. The trader buys Stock **D**, risking another $2,000 approx. or 2%......."

Open Trades

Symbol	Trade	Sector	%Risk	SR	INITIAL Order
D	Long	BANK	2	▼	$21.88 x 833 + $72.904 = $18298.943 on 28/04
C	Long	BANK	2	▼	$20.49 x 887 + $72.699 = $18247.329 on 24/04
B	Long	BANK	2	▼	$17.01 x 1090 + $74.164 = $18615.064 on 20/0
A	Long	BANK	2	▲	$34 x 544 + $76 = $18572 on 1/04/2009

{Seen here again the green arrow indicates share (A) Trailing Stop is above the Breakeven price therefore only risking 4% so the next trade may be entered. }

" …….Later in the week, the trader sees Stock **E** and it looks very bullish. May he buy it?

Not according to the 6% Rule, because his account is already exposed to 6% risk in Stocks **B**, **C** and **D** (he is no longer risking equity in Stock **A**). He must PASS up Stock **E**.

A few days later, Stock **B** falls and hits his stop. Stock **E** still looks attractive. May he buy it?

No since he already lost 2% on Stock **B** and has a 4% exposure to risk in Stocks **C** and **D**. Adding another position at this time would expose him to more than 6% risk for the month……"

In his book *'Come Into My Trading Room'*, Dr. Alexander Elder concludes his section on the 6% Rule with:

" ….. Most traders go through emotional swings, feeling elated at the highs and gloomy at the lows. If you want to be a disciplined trader, the 2% Rule and the 6% Rules will convert your good intentions into the reality of safer trading."

I wish you trading success,
Joseph Barrington-Lew

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A. Help you hone your trading and investing skills and

B. Build your confidence and abilities

so you will be best prepared **to take maximum advantage of rising trends.**

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- **Combine fundamental and technical analysis to help improve selections**
- How to manage your money and risk as a vital key to success in the market
- **How to create your own Trading Plan** with a set of Jim's documented rules for you to follow to help you increase your chances of survival and long term profitability

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- ✓ Precisely **WHEN to Buy** and, most importantly, to know
- ✓ **WHEN to SELL** -- with confidence.

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