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Mentoring-style 'Investing & Online Trading' Stock Report



MONEY & RISK MANAGEMENT

Your Money & Risk Control 101

By Joseph Barrington-Lew

Joseph Barrington-Lew is the creator of the popular [JBL Risk Manager](#) software

Since we launched our weekly ['Investing & Online Trading'](#) stock market Report 12 years ago, Joseph has written several in-depth articles on the crucial topic of 'Money & Risk Management' - to help traders and investors create sustainable profitability in the market.

The following is an update on one of Joseph's previously published articles. At the end are links which allow you to take a **Free Trial** of Joseph's JBL Risk Manager and to save \$50 this month .

Your Money & Risk Control 101

Successful Trading is about having a proven Trading Plan and how will it help me be a better Trader?

Trading is like any small business, without a written Business Plan you are destined to fail.

Many know of the quote generated by brokers globally **90%** of Traders fail or lose so much of their Trading Capital they find it too hard to recover from.

This statistic has been around for decades, long before computers. In fact all computers have done is help traders lose money faster.

Another phrase regarding computers....**Rubbish in and Rubbish out** but I'm sure you have all heard all this before.

If the majority of Traders lose money, **doesn't it make sense** to do the opposite of what most people are doing?

Of course it does. It's far more than just coincidence that less than **10%** of Traders are familiar with or utilize correct Money, Risk & Trade Management as vital components of any Trading Plan.

Most of the 90% of Traders eventually fail due to lack of interest and insufficient funds to continue.

Others have said Money Management is simply a Stop Loss at some price point to manage risk - but this is Risk Management and does not answer the question; "How many?"

Money Management is correct Position Sizing or how many shares to buy or short sell.

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For over a decade I've been asked;
 "How much Capital do I need to start Trading and what if I haven't enough?"

Let me try and answer the first question with the following example:

Trader One has \$5,000 and the other has \$25,000 and both understand the 2 key rules which I believe are essential for long term survival in the market:

1. Never risk more than 20%* of your Total Capital in Trade value for any one trade and rule
2. Never risk more than 2%* of your Total Trading Capital on that trade.

(* Editors' NOTE: In our weekly 'Investing & Online Trading' Report's [notional portfolio of \\$100k](#), we reduced the maxima for these 2 criteria- see the Table on Page 6 of the 'Introduction and Member Benefits' PDF in the top right margin of the [Members Library](#).)

Some investors choose to use one or more excel spreadsheets to do the number crunching, as I did over a decade ago but that is another story.....

Both these Traders to go 'Long' with (XXX) shares, with an anticipated entry price of \$1 next day (based on today's Close)

Trader #1 (With \$5,000 Trading Capital):

- Uses maximum limits (see above) of:
 - i) $20\% \times \$5,000 = \$1,000$ in any trade and
 - ii) $2\% \times \$5,000 = \100 portfolio risk in any trade
- Buys 1,000 shares with a total trade value of \$1,000
- Risks \$100 (2% of \$5,000), which means (excluding brokerage), if the Share Price (SP) drops equivalent to losing \$100, he/she must exit.
- However, when we include brokerage of, say \$20 (\$19.95 rounded) for both Buy & Sell Transaction costs, then the actual Maximum Risk reduces to (\$100- \$40 brokerage), **i.e. only \$60** - which is far too tight.
- Correspondingly, the Share Price would need to go up \$40 on \$1,000, I.e. 4%, before Trader #1 could break even.

Trader #2 (With \$25,000 Trading Capital)

- Uses maximum limits (see above) of:
 - ii) $20\% \times \$25,000 = \$5,000$ in any trade and
 - ii) $2\% \times \$25,000 = \500 portfolio risk in any trade
- Buys 5,000 shares with a total trade value of \$1,000
- Risks \$500 (2% of \$25,000), which means (excluding brokerage), if the Share Price (SP) drops equivalent to losing \$500, he/she must exit.
- However, when we include brokerage of, say \$20 (\$19.95 rounded) for both Buy & Sell Transaction costs, then the actual Maximum Risk reduces to (\$500- \$40 brokerage), **i.e. now \$460** - which provides more room to move
- Correspondingly, the Share Price would need to go up \$40 on \$5,000, I.e. 0.8%, before Trader #2 could break even.

From this I hope you can see why trading and investing with \$25,000 makes more sense than with \$5,000.

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(Editor: for many years we have also recommended that traders and investors with small portfolios:

1. Wait until they have saved more to increase their portfolio.
2. Meanwhile, that they use their time to [thoroughly educate themselves on all the principles](#) we teach in our weekly Report, including Stock Selection, Timing of Entries and Exits, Trading/Investing Psychology, Money & Risk Management.
3. Steer clear of 'spruikers' offering glossy looking returns to small portfolio owners by trading options / warrants / CFDs - as these instruments are leveraged products, *so losses will usually be magnified as well as profits* .

Trader # 2 will certainly sleep better at nights knowing their risk is under control and that the Share Price only needs to move up a short way before they begin making a profit.

Being a successful trader requires a written and proven Trading Plan that fits your risk tolerance – coupled with strong discipline to stick to that Plan.

As shown above, a trader with less than \$25,000 in Trading Capital means taking more risks and only a few, very talented professional traders have done this in their lifetime.

So in answer to the **question #1**; "*How much Capital do I need to start Trading?*", I answer "*with \$20 to \$25K and as it increases, lower the trade and portfolio risk percentages.*"

Surprisingly, some of the best traders in the World make money less than 50% of the time. The difference is that these traders:

1. Use correct Money, Risk & Trade Management guidelines to determine the number of stocks to buy, their trade risk and portfolio risk and more
2. HOLD when in profit with a Trailing Stop or until their profit target has been achieved
3. EXIT their trade completely with discipline when an Exit Tigger is generated (they exit in full and not keep some '*just in case it goes back up*' as this is emotion and wishful thinking) and
4. Know their Trade Expectancy as a vital component of their Trade Management (refer to previous articles in this Report).

Without these 4 steps in place when you open your next trade, then the *chances are that you will probably made a mistake.....* and therefore risk more than you should.....

Understand that losing trades are a 'normal' part of trading and should be expected, just as winning is. It is impossible for anyone to achieve 100% success rate in the long term. As Jim shows regularly in this Report, two keys are to:

1. Determine where you will exit **BEFORE** you enter, (e.g. Jim sets an Initial Stop in a logical chart position below the most recent Low) and be prepared to be disciplined to exit if that Stop is triggered.
2. Fine-tune your Analysis, Money and Risk Management skills to minimize both the number and size of the losses

My answer to **Question #2**: "*What do I do if I haven't got enough Trading Capital?*" is

"PAPER TRADING IS A GREAT START, USING JBL RISK MANAGER. IT WILL HELP REMOVE YOUR EMOTION AND GUESSWORK FROM TRADING UNTIL SUCH TIME YOU HAVE ENOUGH CAPITAL".

Beginners often tend to have insufficient capital to start with, then compound that problem by overtrading, when they should be doing the exact opposite.

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Good investors succeed with a low ratio of successful investments because they use positions sufficiently small that no one loss will be catastrophic to their account. They tend to have sufficient capital to start with, but even where they do not, they understand that overtrading is fatal to their chances of success.

DEFINITION of 'Position Sizing' by Investopedia: The dollar value being invested into a particular security by an investor. An investor's account size and [risk tolerance](#) should be taken into account when determining appropriate position sizing.

Money Management is all about staying in the game long enough to trade another day and profit by avoiding overtrading. This is done by controlling the size of every trade so that only a small portion of the Trading Capital is at risk at any one time.

A Stop Loss/Trailing Stop is not '*Money Management*'. It falls under the heading '*Risk Management*' and many would agree that making an arbitrary decision on where the stop-loss price point is, would not make sense. This Stop Loss price level must not be at a point where we believe we can accept the loss and no more. It should be where we have determined the evidence to show the trade has gone against us.

For example, many traders and investors, including Jim Berg, use a Technical Initial Stop as their exit price (Stop Loss), set below the recent Low before entry to help control their risk, then move it as a Technical Trailing Stop when in profit - to protect their gains.

Some may also use a Technical, Percentage or Volatility Share Price point where the Trader feels the evidence indicates a reversal.

Before entry, keep in mind if you have set a value as your maximum Trade Size and you:

- i) Lower your risk of loss by raising the stop loss, then if you purchase the original quantity of shares, you will be exposed to smaller price fluctuations before your stop is triggered. Or, if you
- ii) Increase your risk by lowering the Stop Loss you will need to calculate a reduced number of shares to buy.

Position Sizing aka Money Management is your first line of defence against catastrophic loss! It is regarded by successful traders to be one of the most important components of any Trading Plan.

When you combine intelligent Position Sizing with effective Risk Management and use a Stop Loss, you are planning for your long term trading and/or investment success!



**JBL
Risk
Manager**



Joseph Barrington-Lew created his useful [JBL Risk Manager](#) over 10 years ago. Next week Joseph provides an update on the latest version of his popular Money & Risk Management tool.

Meanwhile;

1. In celebration of our 12th Anniversary of this Report, Joseph is kindly offering a **\$50 savings this month**.
2. Click on these links:
 - i) To start your [FREE 30 DAY TRIAL](#) of Joseph's JBL Risk Manager
 - ii) To watch a selection of [Joseph's videos and for more info](#) (including how to upgrade if you have a previous version)

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