Module 5: Managing Risk and Psychology

21 - 25

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21. Risk Management Essentials

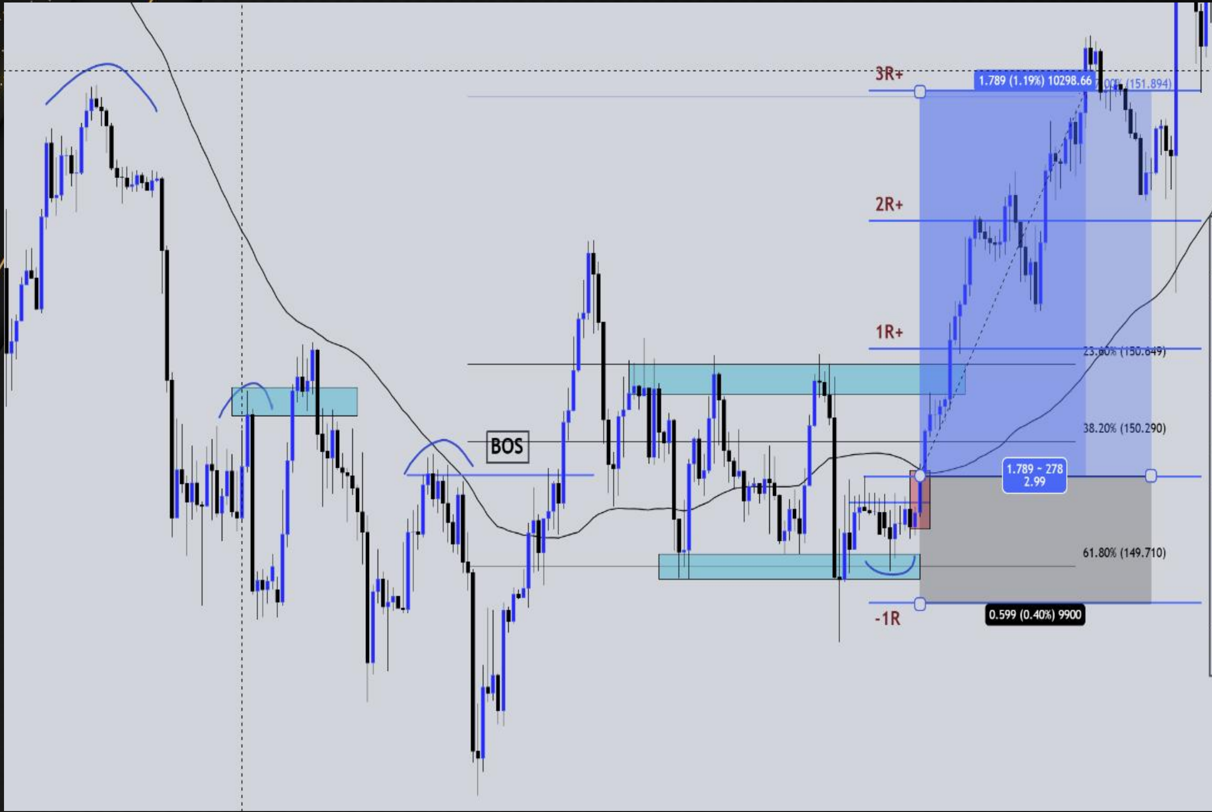
Risk Management

Risk Management is possibly the most important component of trading. It allows you to protect your capital and minimize potential losses when things don't go as planned.

Your capital is the most important asset you have, using risk management effectively will ensure you don't lose too much on a SINGLE trade.

By limiting how much you risk per trade, you can continue to trade even in the event of a series of losses.

22. Importance of Risk to Reward Ratios



Risk to Reward Ratios (R:R)

Very crucial concept, helps assess whether a trade is worth taking based on potential risk.

Most importantly it gives us a framework for how to take on trading.

The amount of money we risk per trade is know as 1R. Regardless of whether the trade has a 10 pip SL or a 50 pip SL, our risk per trade is always 1R.

When trading, we aim for a minimum of a 1:2 R:R. If the trade does not have this potential, do not take it.

In this example, we aimed for a 1:3 R:R.

If risk was $1000 or 1R, we gained $3000 or 3R.
That is 3 times our risk!

23. Avoiding Over Leveraging

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Overleveraging

This occurs when you leverage more than you can comfortably handle. While leveraging amplifies your results, if the trade loses, your losses can be much bigger than intended.

If your trading plan says to risk 2 - 3% MAX risk per trade, yet you decide to risk 5% or even 10% on the next trade … you will be over leveraging and breaking your trading plan.

You can have a series of winning trades, and then give all your winnings back in one or two trades if you decide to over leverage on those trades.

It is very important to know your risk tolerance. Start by risking 1% per trade and slowly scale as you begin seeing results. Do not exceed more than 5% risk.

24. Common Beginner Mistakes

Beginner Mistakes

List of mistakes to AVOID:

- Not using a Stop Loss in every trade
- Not having a trading plan or breaking rules of the plan
- Overleveraging
- Overtrading (3 trades MAX daily [also doesn't mean all 3 must be taken])
- Ignoring Risk Management
- Not journaling trades
- Trading live before properly educating themselves
- Getting locked into a specific bias, unable to see when market is changing
- Focusing on monetary value of trade instead of R:R potential

25. Trading Psychology 101

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Trading Psychology

Psychology in trading is just as important as technical or fundamentals. It is important to have an objective mindset when approaching the markets, that way you wont make emotional trading errors.

Common Trading Emotions:

- Fear
- Greed
- Hope

Fear

Fear:

- Fear of losing can make you avoid taking positions when a trading opportunity presents itself.
- Exiting trades too early (and taking small profits affecting R:R goals) because of fear of the market reversing against your position.

How to manage it:

- Losses are a part of trading, use Stop Loss in every trade to manage accepted risk.
- Focus on a consistent strategy rather than trying to avoid losses.

Greed

Greed:

- Greed influences us to aim for big, unreasonable targets (1:25 R:R for example).
- Take on more risk than we are supposed to as according to trading plan.
- Causes overtrading as we want more ‘chances’ to make money.

How to manage it:

- Set realistic goals and R:R expectations. Aim for 1:2 RR every trade and build the habit of stacking more attainable wins.
- Religiously stick to trading plan.

Hope

Hope:

- This causes us to hold onto losing trades, in hopes that they turn in our favor. In some cases it deludes us to move our planned Stop Loss.
- Also comes in the form of Revenge Trading - continuously hoping the next trade will recover your losses so you keep chasing trades with less analysis taking on unnecessary and impulsive risk.

How to manage it:

- Learn how to identify when the market is telling you when the potential for your trade idea has diminished.
- Stick to Risk Management rules and remember you trading limit for the day.