wiseTraders

THE FOUR PILLARS OF MONEY MANAGEMENT

Follow these four principles to limit your risk and stay in control

I

DEFINE RISK

Always use a stop loss

- This will **protect your account** if a trade moves against you.
- It is important to decide on the initial stop loss positiion in advance, so your risk is always clearly defined.
- Using an initial stop loss also **helps prevent emotional trading.** Never move your stop loss if the price moves against you!
- Only ever adjust your initial stop loss when the price has moved in your favour to the first profit target (P1) level. At this point the initial stop loss becomes a 'trailing stop' according to our P2 rules.

II

DANGER SIGNAL

Set your maximum practical risk threshold

- Each trade's practical risk is the difference between the entry level and the initial stop level.
- Your 'practical risk threshold' is the percentage amount of your account that you are prepared to be at risk when you combine all active trades together.
- Beginner traders should set a very conservative level for this (say 10-20%) to avoid blowing up their accounts through preventable basic mistakes.
- If your account breaches this level, pause trading for a while. The markets may not be helpful, or you may need to make refinements.
- This will **protect your account** from further damage when the markets turn against you and all your trades are getting stopped out.

III

OPEN TRADES

Limit your number of open trades

- The total risk on all your open trades should be no more than the maximum practical loss threshold for your account. This will help you **minimize risk** and **prevent over-trading**.
- As a guide, **five open trades** is a logical and manageable maximum for most traders.
- However, you should not be tempted to always 'meet' this number. You should only trade the highest quality setups. Sometimes that means having five open trades, sometimes it can mean having none!

IV

POSITION SIZE

Adjust your position size

- You should base your position size on your maximum practical risk threshold. All your trades should be top quality setups, so the position sizes should typically be the same on each
- For example, a 15% maximum practical risk threshold on your entire account could allow for 3% total account risk on each of five trades
- With a $10,000 account, 3% account risk on each trade could translate to $300 risk tolerance on a $2,000 trade (assuming a maximum of five open trades). This translates to a 15% risk tolerance on each trade ($300 / $2,000).
- These figures are of course just illustrative to explain the principle.