RISK MANAGEMENT REMASTERED

WRITTEN BY

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Dear Friends.

This is a new series which simply aims to be a complete crypto trading tutorial from beginning to the end.

I promise to deliver all I know, if not the best.
Please read everything in this series and I will also make an index of it.
You will be able to understand all tools, including Orderflow in the future if you keep at it.

Expecting your help in keeping the best trading education free.

Yours,
EmperorBTC.

INTRODUCTION

If you have any amount of trading experience, you already know that 90% of the traders lose money. If you have no amount of trading experience, please drill it in your mind that 90% of the traders will lose money. Everything discussed below will aim at possibly not being the traders who lose money.

The first step of winning is to ensure that you won't lose.

What must be analyzed deeply is how you approach trading. Movies and shows glorify "THE ONE BIG TRADE" and everyone waits for their big shot and moment of glory. From this moment please know that getting rich with one trade or with one big luck is not what trading is about. Only if you can believe in the mindset that you will have to take many trades with a small position size, only then should you be trading. Remember, a big position size on one bet means disaster. We get rich by consistent small bets.

Trading is just a skill that requires brutal discipline to learn and practice daily.

THANKS TO THE SPONSORS

I'd like to extend my sincere gratitude to zignaly.com for sponsoring this tutorial pdf. With over 430,000+ users, the Zignaly platform is leading the social copy-trading solution by connecting crypto investors with the world's top expert traders in a profit-sharing model, creating equal investment opportunities for everyone.

Founded in 2018, Zignaly.com's offerings feature unique powerful tools for Investors looking for Portfolio Management services, staking vaults, ZIGPad (launchpad), NFT raffles, and asset bridging solutions - all powered by the ZIG Coin.

Backed by a strong partners network, the team at Zignaly built the ZIGcoin (ZIG) with the sole purpose of empowering Zignaly users, and now looking to expand the reach of the ZIG Coin beyond its ecosystem with various integrations and partnerships.

Zignaly is also looking forward to announcing major updates and a new roadmap in the month of June as per their social media.

You can check out Zignaly and its copy trading platform on the following links.

- Twitter — English https://twitter.com/zignaly
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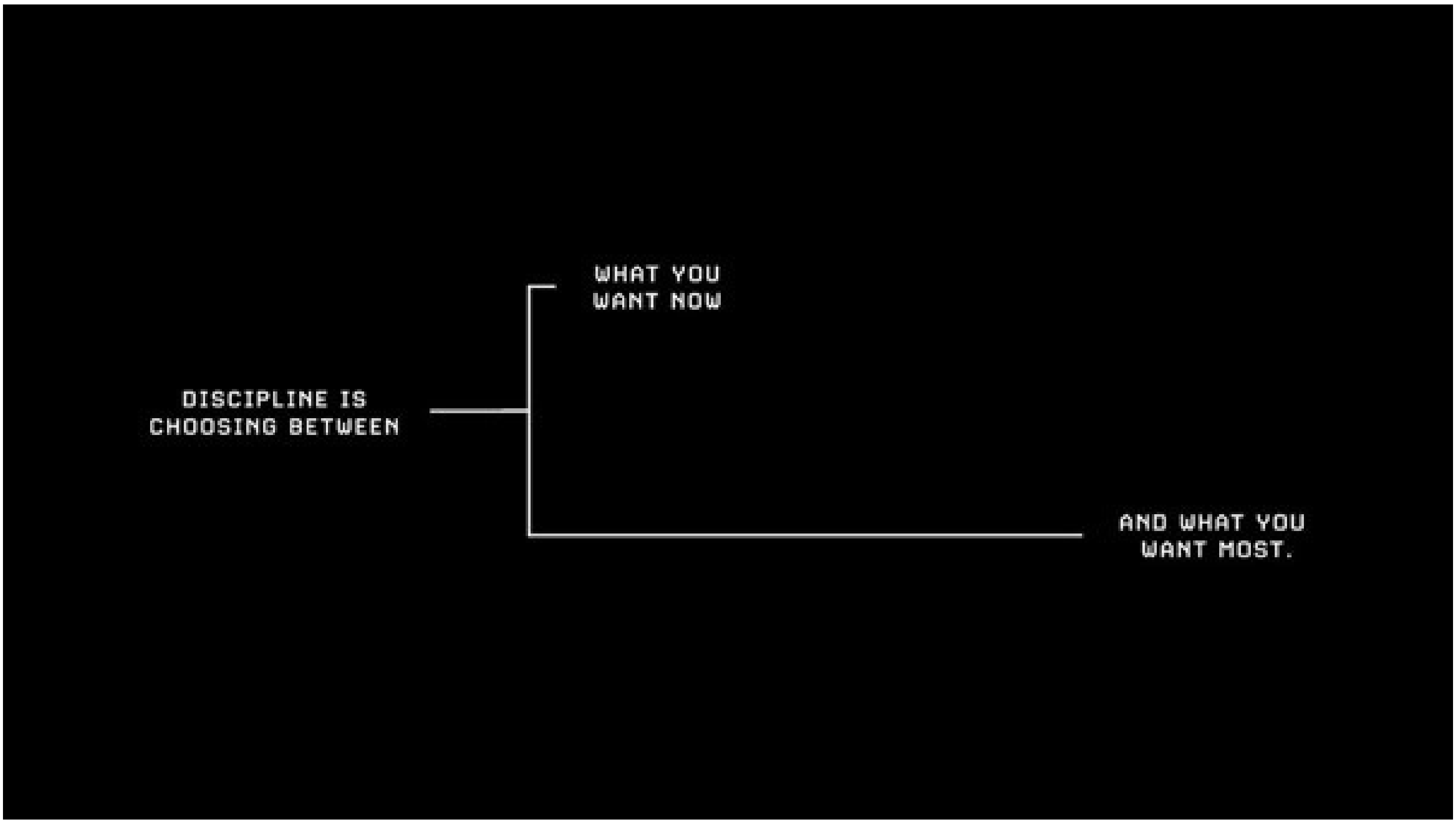


Discipline and consistency are the two factors that differentiate trading from gambling, regardless of your trading style and strategy.

What is the importance of risk management?

Risk management is crucial to any trading strategy or style as a trader can't be profitable if he's wiped out within a string of a few bad trades. You need to protect your capital because that is what ensures your survival and ability to bounce back regardless of the bad week/month/year that you may have.

First question, how big should your trading account be? What I can say with certainty is don't put all your money into your trading account, it should be large enough to hurt if you lose your entire account but not enough to lead you to financial ruin.

LOSS OF CAPITAL	% REQUIRED TO GET BACK TO BREAKEVEN
10%	11%
20%	25%

LOSS OF CAPITAL	% REQUIRED TO GET BACK TO BREAKEVEN
10%	11%
20%	25%
30%	43%
40%	67%
50%	100%
60%	150%
70%	233%
80%	400%
90%	900%

The table above shows how much profit is needed to recover your losses during a drawdown. Therefore, it's important to cut your losses.

Basics

Risk to reward: ***(R:R)***

This ratio denotes how much money you make on a successful trade vs how much money you lose being unsuccessful on the same trade

$$\text{Risk/Reward Ratio or R/R Ratio} = \frac{(\text{Entry Point - Stop-Loss Point})}{(\text{Profit Target - Entry Point})}$$

Let's take an example:

You buy a stock for $100, you have a target of $200 and a stop loss of $50.
What is your R/R for this trade?
R/R = (100-50)/(200-100) = 1:2

Let's take an example to analyze success rate now:

You toss a coin 10 times and get tails and heads 50% of the time individually.
You make $5 every time it's heads correctly and lose it on every tails.
Here the R:R ratio is ($5/$5) = 1:1.
You also know that your success rate is 50% as we get heads 50% of the time.

At the end of 10 tosses, PnL = $25 (win) - $25 (loss)
= $0

Let's say that you now get heads 60% of the time with same conditions.

At the end of 10 tosses, PnL = $30 (win) - $20 (loss)
= $10

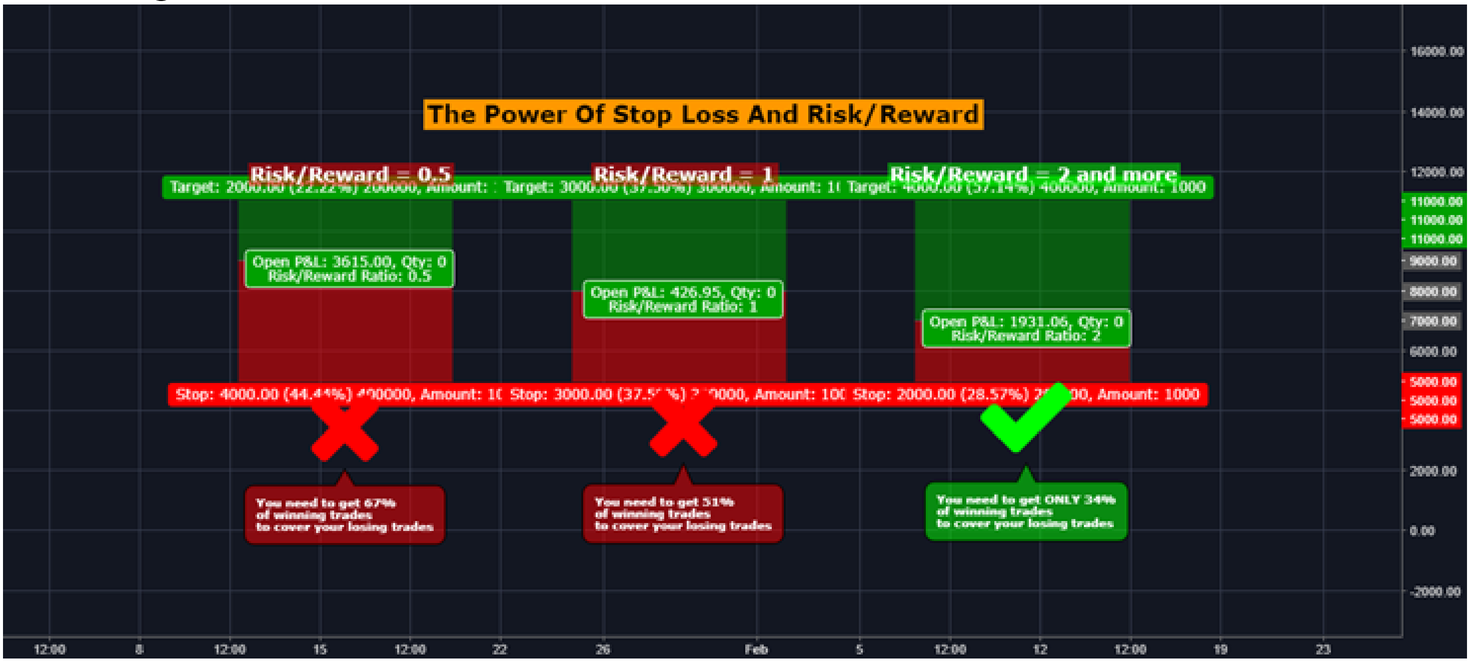
Now if you retain the original success rate but make $10 on every heads instead of 5, your new R:R ratio is ($5/$10) = 1:2.

At the end of 10 tosses, PnL = $50 (win) - $25 (loss)
= $25

At the end of 1000 tosses, PnL = $5000 (win) - $2500 (loss)
= $2500

Thus, you notice that the R:R ratio on your trades is just as significant as your success rate and they are independent. Many successful traders are successful 50-60% of the time but still make huge profits over thousands of trades due to risk management and R:R ratio.

Balancing R:R ratio and Success Rate:



<u>The following chart shows the R:R ratio visually and explains what success rate is required to remain at breakeven statistically for different R:R setups.</u>

Now the most frequent question is, how much to risk per trade?

Most traders agree that you shouldn't risk more than 2-5% of your total account balance per trade.

Although this is not incorrect, it is considerably more complicated.

Let's imagine you have $50,000 and have had a run of six losses in a row. If you think having six losses in a row is improbable, consider this table, which indicates the possibility of having consecutive losses based on the strategy's percent strike rate.

	Probability of X consecutive losing trades within a 100 trade sequence									
Win rate	1	2	3	4	5	6	7	8	9	10
5%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
10%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
15%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
20%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
25%	100%	100%	100%	100%	100%	100%	100%	100%	100%	99%
30%	100%	100%	100%	100%	100%	100%	100%	100%	98%	93%
35%	100%	100%	100%	100%	100%	100%	99%	95%	85%	71%
40%	100%	100%	100%	100%	100%	99%	93%	79%	61%	42%
45%	100%	100%	100%	100%	99%	93%	76%	54%	35%	21%
50%	100%	100%	100%	100%	95%	78%	52%	31%	16%	9%
55%	100%	100%	100%	98%	83%	55%	30%	14%	7%	3%
60%	100%	100%	100%	92%	63%	32%	14%	6%	2%	1%
65%	100%	100%	99%	77%	40%	16%	6%	2%	1%	0%
70%	100%	100%	93%	55%	21%	7%	2%	1%	0%	0%
75%	100%	100%	79%	32%	9%	2%	1%	0%	0%	0%
80%	100%	98%	54%	14%	3%	1%	0%	0%	0%	0%
85%	100%	89%	28%	5%	1%	0%	0%	0%	0%	0%
90%	100%	63%	9%	1%	0%	0%	0%	0%	0%	0%
95%	99%	22%	1%	0%	0%	0%	0%	0%	0%	0%

Probability of a losing streak based on your win rate.

This chart shows the importance of risk management. Even if you have a 60% win rate, there will come a time when you'll have 5 consecutive losing trades. You need to survive those with enough capital to not be affected and that is how you calculate position size and risk per trade.

NOTE:
My personal preference is 2-3% risk per trade as I mostly scalp and the number of trades per month is high.

Position Sizing:

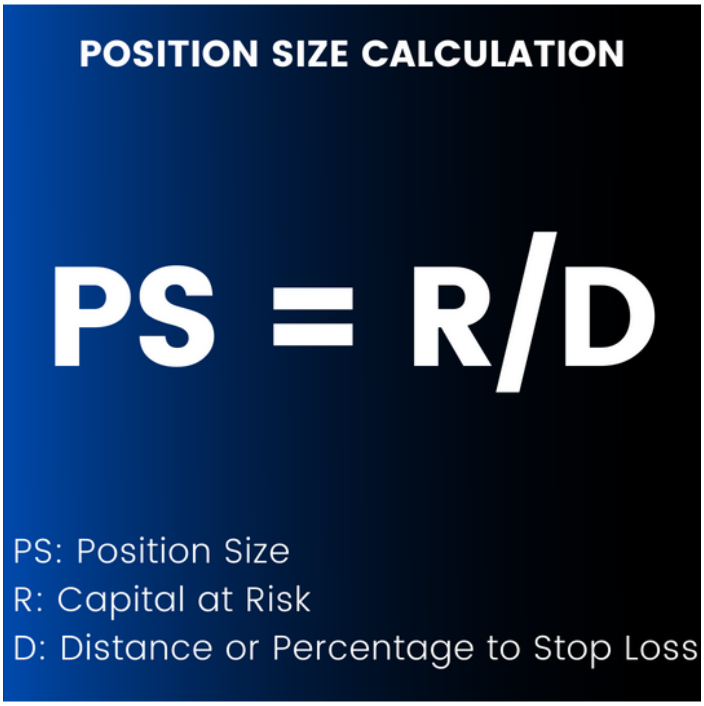
How much should you personally enter a trade with? First, you must understand that capital preservation is key, and with your success rate and you should be able to survive any losing streak with a probability of greater than 20%.

Now, you must understand that when we talk about 3% risk, you don't open a position with 3% of your account, instead, if you take a loss on that trade, then you lose 3% of the account. To enter the trade with this condition in mind, you need to understand what position sizing means.

Many authors suggest 1% per trade but let's stick to 3% for this example.
3% is the amount of risk you're taking on.

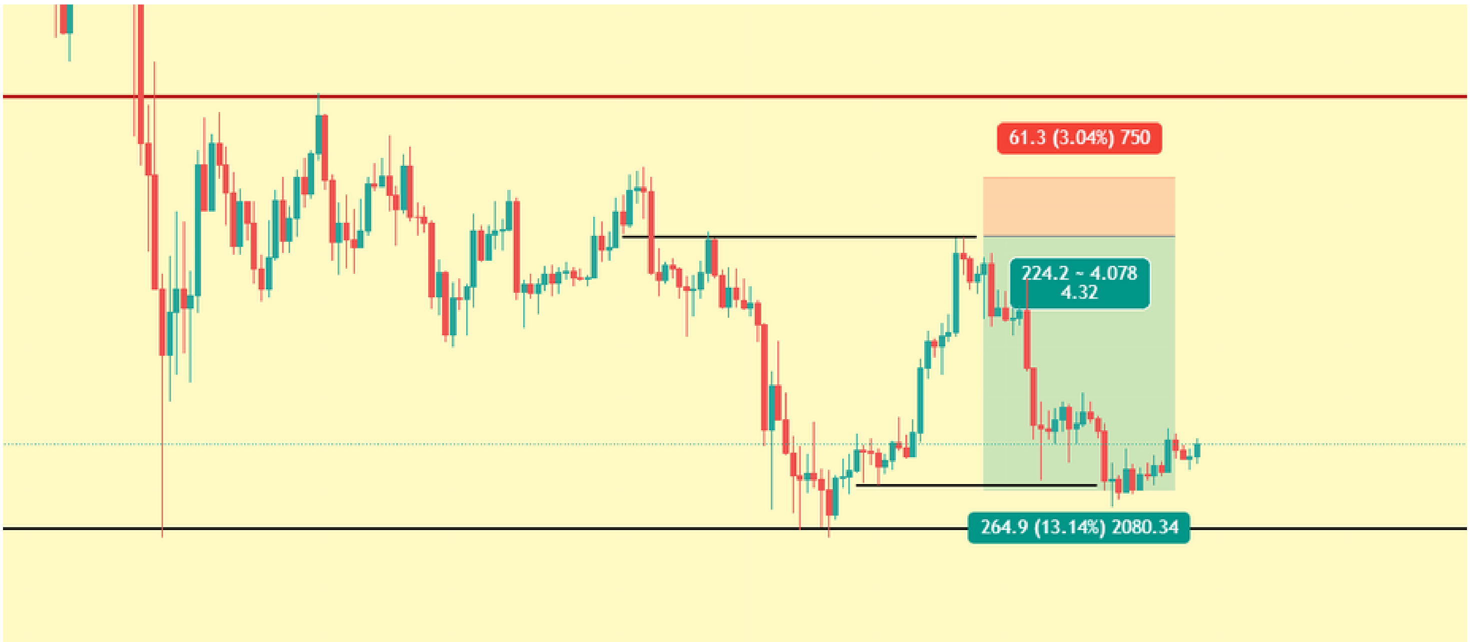
Your Position size will depend on WHERE THE INVALIDATION level is.
To re-iterate, let's say you have 100K dollars and choose to risk 3%.
That's 3K Dollars.

If you're risking 3k, and your invalidation is 4% below your entry, then your position size is 75k.
If you want to trade with a position size of 75k. You can either buy/short using 75k without leverage or you could use for example, 5X leverage and use 15k as margin. WE WILL ONLY LOSE 3% instead of 70-80% AND still trade with such a big position size.



Example:

This is a recent trade I took on $ETH.



Reasoning: Volume Profile analysis + Range play + Confluence of order book for the horizontal levels marked.
(they are abstracted to focus on stop loss placement and entry)

For example, let's say our Trading Capital is 100K Dollars.

We want to risk a maximum of 3% in each trade i.e. 3000 dollars

The Position size is defined as below:

Risk Amount ÷ Invalidation Distance in Percentage

Hence in this trade, we can trade with 100K worth of Position Size BY ONLY RISKING 3K Dollars.

SL (Stop Loss) at 3% -> from chart

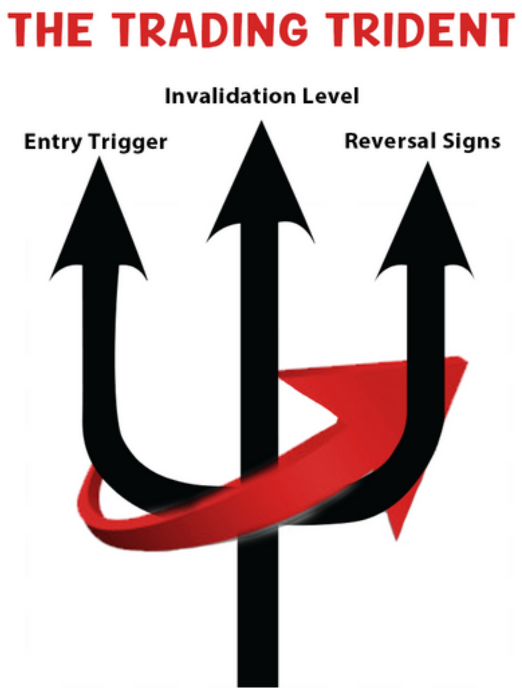
Total Capital = 100k

Capital to risk = 3k

Position size = 3k/Distance to SL

Trading Trident:

This is something that I've talked about before and still emphasize to this day. In this section, we will learn to put together all aspects of risk management that we've learned so far.



One should only enter a trade if you have a clear 'Trading Trident'.

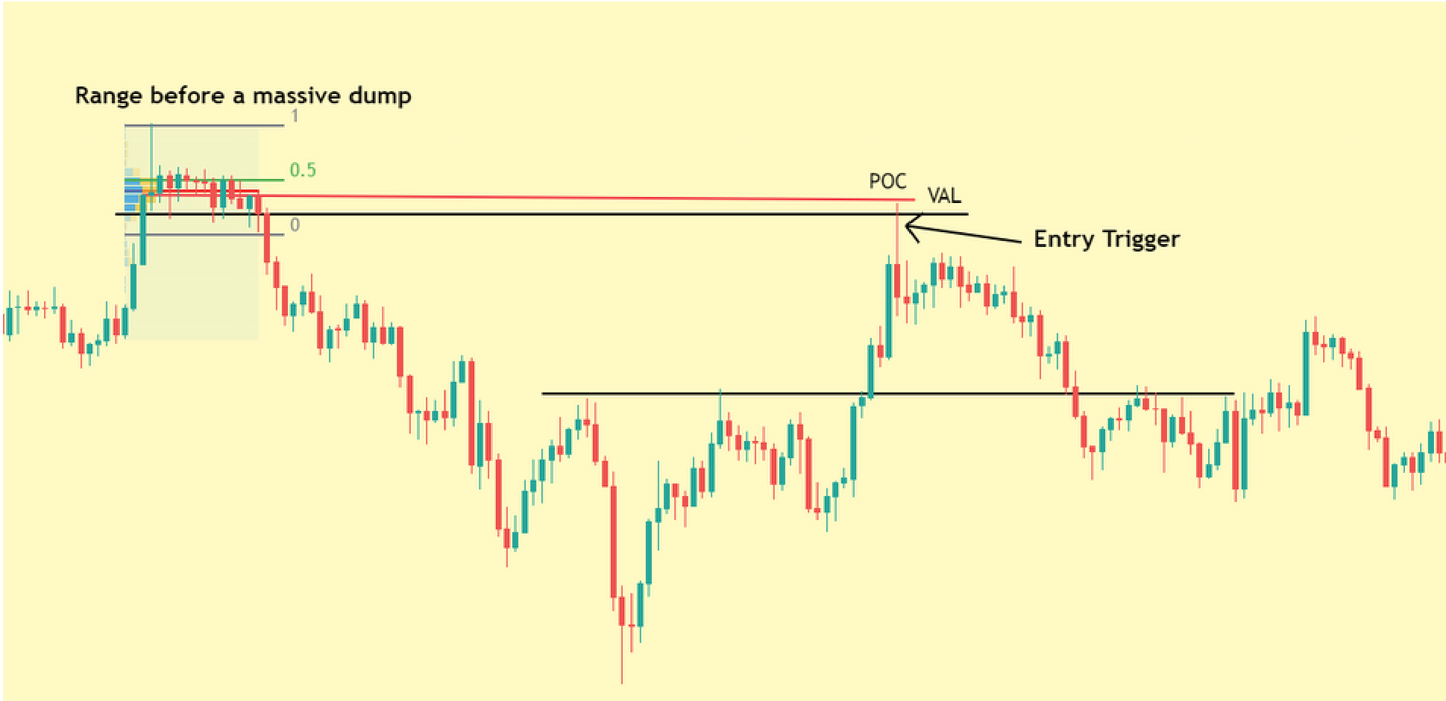
1. Entry Triggers as per your trading technique
2. Established invalidation levels (Stop loss)
3. Defined reversals (Profit-taking)

Entry Triggers:

·S/R flip confirmed with horizontal range levels

·Retest of previous range POC after breakdown

These are just examples that you need to define with your strategy.



Stop Loss:

The price in the opposite direction of the trade where the trade is exited, at a loss.

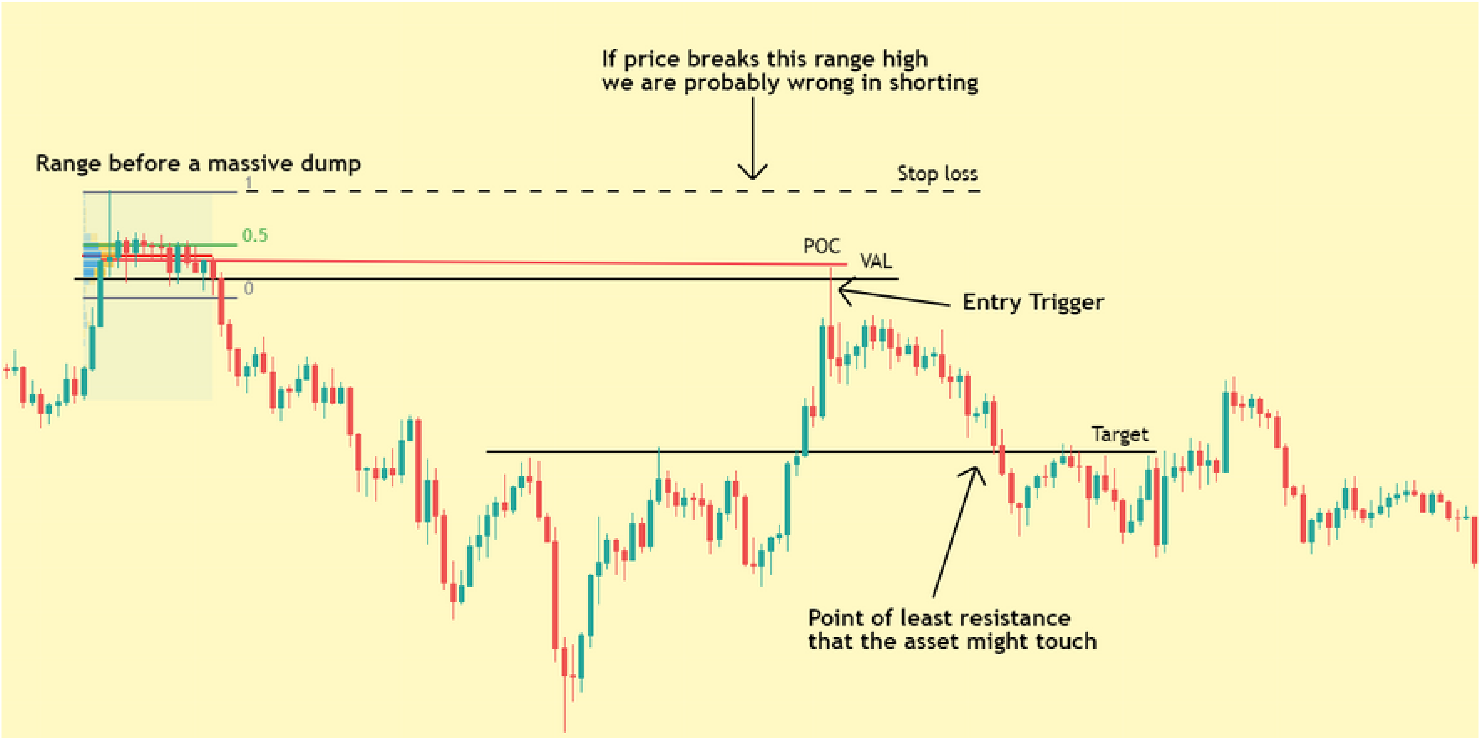
At this level, the reason for the entry becomes invalidated according to TA and the price can then move in the opposite direction, probabilistically.

Target:

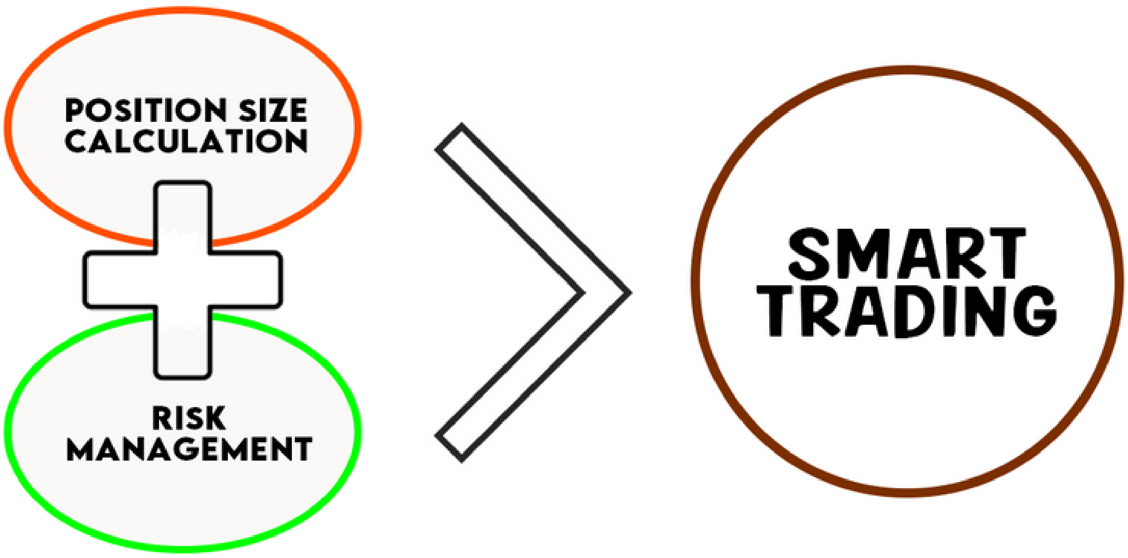
It is the possible price level that the asset might touch based on previous trends or confluence AND where a possible reversal could occur.

Target is the next path of least resistance from where the price might reverse.

We will always ONLY use TA to determine all 3.



Always keep in mind:



Implementation (Active Risk Management)

Let's take a simple example of active risk management. Theoretically, you now know everything you need to know about deciding risk per trade. What about taking gradual profits or getting out of a trade early? It's not always as simple as placing your stop loss and forgetting about it. I learned a lot about this aspect of trading from Tom Dante (@Trader_Dante).

Example:

Let's say we want to short a 3 touch level we expect to act as resistance and missed the target by a few %. We did not take profit and now the price went above entry but did not hit stop loss.

We notice how the price reacts sharply to the level flipping it as support.

Now our original trade idea of shorting resistance has been invalidated. So, we get out without taking the full loss. Just remember that having a fixed stop loss doesn't mean you take the full loss all the time. You get out when your idea has been proven wrong.

Evolving R:

The concept of evolving R was popularized to perhaps everyone by Trader Dante.

When they're in profit (and want to bank it as fast as possible), novice traders are terrified, and when they're in the red, they're hopeful (Unrealised loss makes them hope that the trade still works out). You want to do the inverse of amateurs, thus psychology is quite crucial for trade management.

Consider this sample trade:

In these scenarios, traders move their stops to entry and then sit on their hands hoping for 1 more R. The thinking is that it is a free trade now.

Evolving R is a concept that explains that your Risk: Reward ratio is always changing when you're in a position.

Evolving R is visualized for you. You're up 6% after risking 2% on the trade, and you're now risking that 6% to make 2% more. This is when you place a market order and then exit the trade with a large profit.

Beyond the entry, goal, and stop-loss, there is a certain degree of planning that goes into making a trade. The evolving R notion does not imply that you should exit all your trades as soon as you make a small profit. When the trade seems to be slowly reversing on you and the evolving R is less than 0.5, that's when you START TO CONSIDER an early exit and secure profits.

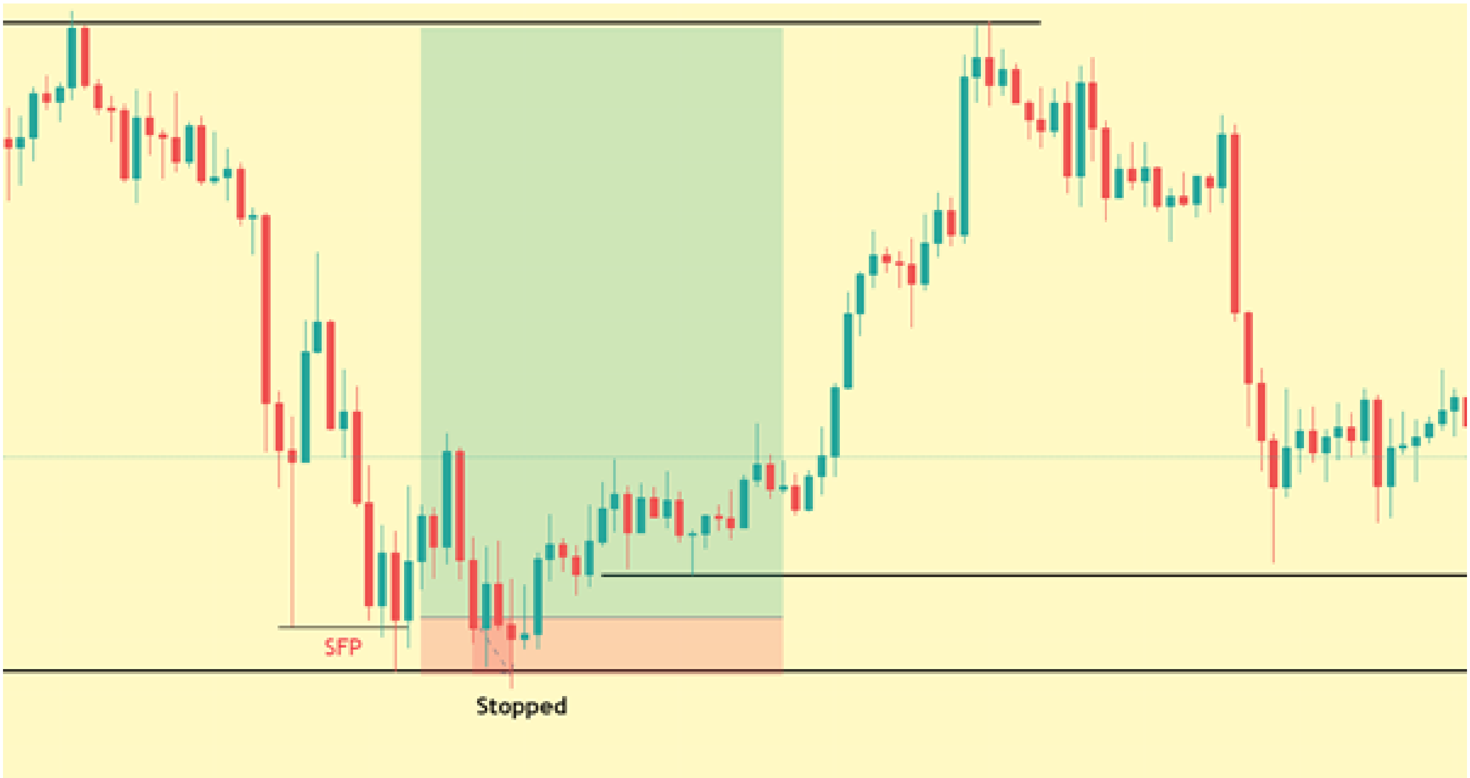
Not having a fixed stop (advanced and risky):

"You must have a fixed stop loss at any cost."

This makes sense for beginners who need to stay away from high leverage and blowing up accounts, but as you venture deeper into trading, you'll realize that sometimes it is not in the trader's best interest to do that.

Stop-loss orders will exit a trade at a predetermined price; once that price level is reached, your trade will be realized at a loss.

This frequently results in situations like this.



In these situations, you might want to have a mental stop loss that if said candle closes below the SFP candle, then I'll take a loss.

So you can't place a fixed stop here and it makes sense to not do so. How do you handle such situations? We make use of Trader Dante's ATR technique.

ATR trick for placing stops when trading an SFP. Use this in addition to the SFP tutorial.
Link: https://t.me/EmperorbtcTA/493

In choppy Price Action, we sometimes must wait for a sweep of a sweep (sort of like a 3 tap) and can't enter because we might just get wicked out and obviously can't have a manual stop because we can't position size accordingly.

So, we can use the ATR to have a safety stop.

Settings need to be modified to 24 but just look at the ATR value of the "sweep" candle and then place your stop that much above the high/low.

This way you can position size properly.

If a candle closes above your SFP high, of course you close manually, but this is the option to not get stopped out on that one extra sweep while also having fixed invalidation.

THANK YOU FOR READING

I hope this PDF helps you in understanding the following aspects of trading:

1) Risk Management and its importance.
2) Calculation of Position Sizing and understanding that leverage is not important over it.
3) Importance of stop loss and the trading trident.
4) How to effectively place a stop loss and calculate position size when trading SFPs.
5) When to get out of a trade before your stop loss is hit and capital preservation,

If any doubt remains, you can comment about it on the tweet and I will answer back.

This is the first PDF of a new series and we will continue to add onto this series content that will help any trader master Bitcoin Trading from basics to Orderflow.

Love,
EmperorBTC