BY LEVIATHAN

RISK MANAGMENT

POSITION SIZE

Position size = risk amount / distance to stop loss

Trading capital: account balance, portfolio size
Entry price: the price where your buy/sell order is executed
Stop loss: the price where your order to close a position is triggered (to prevent further loss)
Risk amount: the max amount of capital you can lose if stop loss is triggered
Leverage: borrowing capital from the broker to increase your position size
Distance to stop loss: (entry price - stop loss price) / entry price

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Calculating **position size** allows traders to have a **fixed amount of risk** per trade no matter the market movements.

This means that if one's trading capital is **$1000** and their risk per trade is **2%**, they will never lose more than **$20** (risk amount) in the case of a losing trade (triggered stop loss).

Leverage does **NOT** have an impact on the position size.
It allows a trader to open a position larger than their capital (when required by position size calculation)
*Important: SL needs to be triggered before liquidation price.

To calculate your position size, you need to:
1. Decide on **entry price**
2. Decide on **stop loss** (based on TA)
3. Decide on **risk amount** (e.g. 1-5% of **trading capital)**

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EXAMPLE 1

Trading capital: $10,000
Risk: 3% (0.03)
Risk amount: $300 (10,000 x 0.03)
Distance to stop loss: 5% (0.05)
Position size = risk amount / stop loss = $300 / 0.05 = $6000
Check: $6000 - 5% = $5700 -> $300 loss

EXAMPLE 2

Trading capital: $1,000
Risk: 2% (0.02)
Risk amount: $20 (1,000 x 0.02)
Distance to stop loss: 7% (0.07)
Position size = risk amount / stop loss = $20 / 0.07 = $285,7
Check: $285,7 - 7% = $265,7 -> $20 loss

EXAMPLE 3

Trading capital: $10,000
Risk: 4% (0.04)
Risk amount: $400 (10,000 x 0.04)
Distance to stop loss: 2% (0.02)
Position size = risk amount / stop loss = $400 / 0.02 = $20,000
Check: $20,000 - 2% = $19,600 -> $400 loss
***This example is where leverage is needed to increase position size**