Money Management by Walter Bressert

Before entering the market, determine a stop/loss as a profit objective
Many traders often enter the market with a price objective, but without a clearly defined protective stop. When the market moves against them they are often forced out of the size of their margin call. They lose control, and the results are often disastrous. What should have been a relatively small loss becomes an extremely large loss.

With a pre-determined price objective and a pre-determined stop/loss, you know where you will get out if you are wrong and where you will get out if you are right. You have control. The stop/loss must be in the market, not in your mind.

If you have been stopped out only to have the market make the move without you, the problem was how you determined where to place your stop, not whether to use stops.

Never risk more than 10% of equity on any single trade. If possible, risk 5% or less. Never risk more than 20% in any one complex. If you are like most traders, you always figure how much you could make. The question of how much you could lose if you are wrong is never quantified. You are out of control.

The most important question in trading leveraged markets is – How much of your equity is at risk? On any given day, for any given trade you must know how much you will lose if the market goes against you. You can maintain control by never risking more than 10% in any one trade, and by adjusting stops so you are never risking more than a maximum of 20% of open equity at any time.

In reality, the 20% risk factor should exist for only a few days at most, as explained in the following multiple contract approach which will greatly reduce your exposure within several days of entering the market.

Trade multiple contracts

One of the most important concepts is to trade in multiples of three. Whether two, three, ten or a hundred contracts are traded, most traders make the mistake of entering and exiting all contracts at the same price level. They are going to be all right or all wrong. In using

multiple contracts, no fewer than three contracts should be traded per position, and one-third of each position should have a different profit objective. If trading three contracts, each contract would have a different price objective; if trading 90 contracts, each grouping of 30 contracts would have a different price objective. With each 1/3rd of a position having a different price objective you can be wrong on your expectations and still make money!

For example, a $30,000 account risking 10% of equity can afford to risk $3,000 on the overall position. If the dollar risk per contract from point of entry to stop/loss is $900, commissions and skiddage might equal another $100; the dollar risk per contract is $1,000 with a total $3000 for the three contracts in the position.

Contract No. 1: The Money Contract

The first contract, called the Money Contract, is the most important. When possible, the profit figure for the Money Contract should equal the dollar risk, but should seldom be more than $1,000 under normal market conditions. In our example, the pre-determined dollar risk per contract, including skiddage is $1,000, so our pre-determined profit objective for the Money Contract is also $1,000.

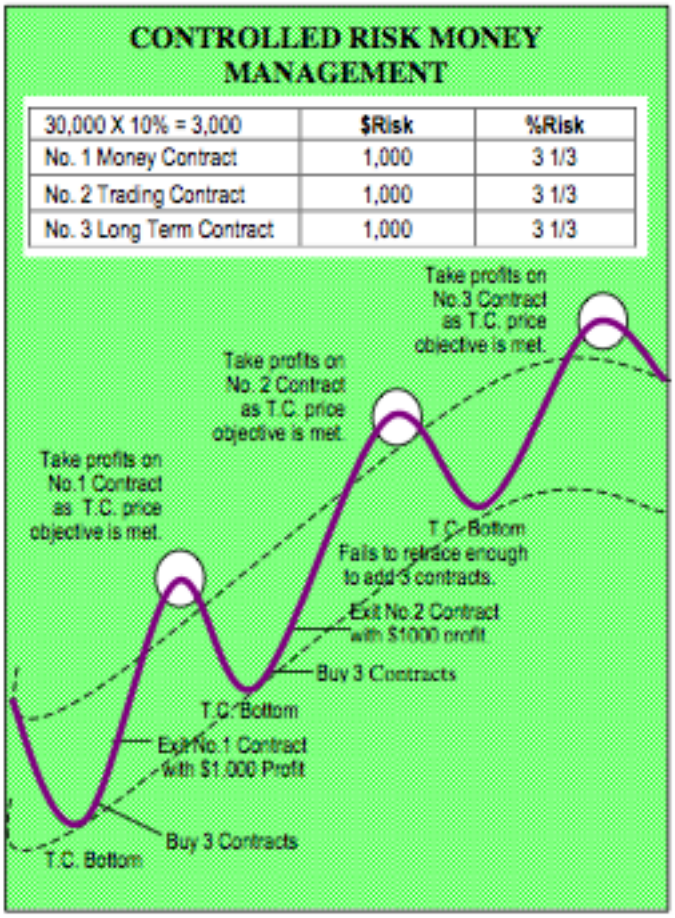
It is important to have all three contracts on before the market moves. All three contracts can be entered at once, or can be put on at different price levels. Once the three contracts are positioned, place an exit order for the money position at the pre-determined profit objective. This order should be placed every day before the open.

Profits on the money contract should be taken as quickly as possible. Normally, the money contract should be liquidated within five market days. If not, you may be expecting too much from the market you are trading, or the market may be telling you that it is not going to move in your direction.

When the money contract is liquidated, the whole tone of the market changes because, now your risk is lowered by two-thirds of your initial risk exposure, and best of all, you have $1000 in closed profits in your account.

In our example of a $30,000 account risking 10%, a three-contract position was entered at $1,000 risking 10%, or 3 1/3% risk per contract. Once profits have been taken on the Money Contract, not only has its 3 1/3% risk for the Number 2 Short-Term Contract,

dropping the total dollar risk to about 3 1/3% for the two remaining positions – your emotional commitment is similarly reduced.



Contract No. 2: The Short-Term Profit Objective Contract

The Short-Term Contract is also designed to take profits at a pre-determined profit objective. Normally, this can be the crest of a Trading cycle in a bull market, or the Trading Cycle trough in a bear market. Either get out at this price objective, or as prices approach your price objective, move stops closer and have the market take you out.

In our $30,000 account, if you make $2,000 on the Short-Term Contract, you now have $3,000 in closed profits and a third position that has a $2,000 open profit.

Contract No. 3: The Long-Term Profit Objective Contract

The purpose of the Long-Term Contract is to keep you in the market

for the BIG moves. Assuming you liquidated the Short-Term Contract near the Trading Cycle top, the Long-Term Contract will give up some profit as the Trading Cycle bottoms. But, the purpose of the Long-Term Contract is to comfortably ride with the market until your long-term price objective is reached, which is often the price objective for the Primary Cycle or the Seasonal Cycle.

These money management concepts can be modified depending upon the position of the Trading Cycle and when the buy/sell signal is generated.

Shown in the following example is the first three-contract position, which is entered at the Trading Cycle bottom with a dollar risk of about $1,000 per contract (point of entry to the Trading Cycle low, which is the stop, plus commissions and expected skiddage).

Within several days of entry, the No. 1 Money Contract should be liquidated with $1,000 profit. As the Trading Cycle moves up, a $1000 profit is taken on the No. 2 Short-Term Profit Objective is met. The No. 3 Contract is held through the Trading Cycle bottom in anticipation of reaching the higher Primary Cycle or Seasonal Cycle price objective. As the Trading Cycle bottoms, three more contracts are bought for a total of four contracts – two Long-Term Contracts, the Money Contract and the Short-Term Profit Objective Contract. As the market moves up, the money contract is liquidated at the pre-determined price objective and a short-term profit is taken as the Trading Cycle tops. Both Long-Term Contracts are held expecting higher prices as the long-term objective is met.

As the next Trading Cycle bottoms in this example, the market does not retrace as expected; so new contracts are not added. The market takes off without the additional three contracts, but leaves two Long-Term Contracts that can be liquidated at two different price levels as the Primary Cycle tops. Should the market fail to reach the long-term price objective, technically determined fail-safe stops must be maintained for the two remaining Long-Term Contracts. But, assuming all goes well, each of the two Long-Term Contracts can be liquidated at different price levels as the long-term objective is met. (My own approach is to take one-half of the profits on strength before the market tops.)