Money Management

Phuket Trader has a range of techniques to control your investments in varying complexity

1 . Fixed wager, wager as percentage of equity, wager as percentage of equity but based on the projected stop loss

2. Fixed stop loss and fixed take profit

3.Set stop loss and take profit on a nominated ATR (Average True Range)

4. Close trades on reversal of indicators, close trades on support or resistance levels.

5. Trailing stop loss

6. Set stop loss to break even after a nominated pip profit.

7. Set take profit on a risk v's reward nominated ratio

8. Increase wager by a nominated multiple progressively on losing trades (up to a limit 20% of equity)

9. Increase wager if a nominated pip gain is not achieved (up to a limit 20% of equity)

For any given currency set and time period, the equity curve and maximum drawdown are progressively improved as points 1 to 9 are introduced.

We all are aware of the Martingale system and how it has been comprehensively disproven. The casinos control this type of bet progression by setting minimum and maximum wagers. Typically the maximum is 100 times the minimum. For example a minimum $5 table will allow a single wager of $500. In Martingale a progressive losing bet sequence would be 5, 10, 20, 40, 80, 160, 320 and then the final wager would be 500 but that bet would result in an overall loss even if it was a winning wager. So in reality a sequence of 7 losses only allowable to recover a profit of $5.

In trading, there are tools which are much more sophisticated, such as being able to regulate our risk / reward ratio, a minimum wager of .01 and a maximum wager of nominally around 50 so our minimum to maximum ratio is around 5000. This, combined with the risk v's reward ratio and the ability to set our bet progression ratio to any figure give us a very powerful arsenal. Combine all this with our detection abilities (fundamental and technical), I sincerely believe we are only tapping the surface at the moment. Our most formidable opponents are the market makers and the major bankers who control the price flow. We all know how many EA's are in existence both commercially and through the forums which display great promise with curve fitting techniques and ultimately never hold up because of the constantly changing marketplace.

Remember the great CHF debacle where many got burnt when the Swiss Franc realigned to the US Dollar. Nobody really had the insight to see it coming but we did see some brokers actually advertising that they were going to write off client losses in a bid to retain customers. The stop loss should be a critical part of your trading plan. Be very alert for major news releases and your potential over exposure.

This brings me to the point of this post, I have just completed a massive back testing exercise where all the money management factors were optimized on a continuous straddle strategy. Why this strategy - because we really never know how the market is going to behave so I am putting greater emphasis on money management. The most powerful weapon by far is the ability to leverage your investment.

In a nutshell, just say we have a potential investment of a percentage of our equity say 2% of $5000 ie. $100.

So we wager $100. Realistically what are our expectations, say win $100 or lose $100.

What if we viewed it like this - if we lowered our investment size but employed a trailing stop loss, set stop loss to breakeven, increased our wager size with consecutive losses, employed a risk reward ratio and set a minimum level for a result not to be treated as a loss.

The basic result on back test AUDUSD one minute over a 2 year period on a continuous straddle. Simple TP and SL with no trail resulted in a S1930 profit and various increasing returns as each successive factor was progressively introduced up to a full optimization profit of $28,429.

This is the astounding part - that return was produced from a initial investment of just 0.5% of equity. The absolute essence of it is the stop loss multiplier of 2 (the result of an optimization from 1.1 to 2 with a step of . 1) and the low initial wager. I have purposely capped the maximum wager at 20% of equity. (After that back to the .5%). The values achieved during back test will of course vary with scenarios. My preference is for a starting point of 2% of equity and a Wager Increase Multiple of 2. This gives a progression of 16 losing trades before reaching the 20% cap of equity value. If you reduce the initial starting point percentage you are able to achieve a greater losing sequence before reaching 20% of equity. As a result of my back testing on all currencies and all time frames the 16 loss sequence seemed quite adequate.

The real point here is that you need to be in a position to make the most of that winning trade when it comes, and if it takes a number of break evens or low profit wins (because of the trailing stop loss caught up), you are giving yourself the best chance to capitalize. You have to accept that on some trades you will simply have a “bad hair” day.

It is not necessary to be in a trade all the time