Fundamentals of Risk Management

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Overview

- Risk Management
- Components of Trade Risk
- Applying Risk Management Components
- Risk Management Plan
- Mechanical Risk Management
- Risk Management Examples

Risk and Management

What is Risk?

- Definition: A situation involving exposure to danger

What is Management?

- Definition: The process of dealing with or controlling things or people

- In situations that have risk, the lack of identification and management of risk is described as a threat.
- Humans are constantly performing variations of Risk Management with choices and activities every day.

Risk Management

There are 18 black slots, 18 red slots, and two green slots.

Your chances of hitting a black or red are equal: **47.4%**.

Casino probability will be **52.6%**, because of those two green slot.

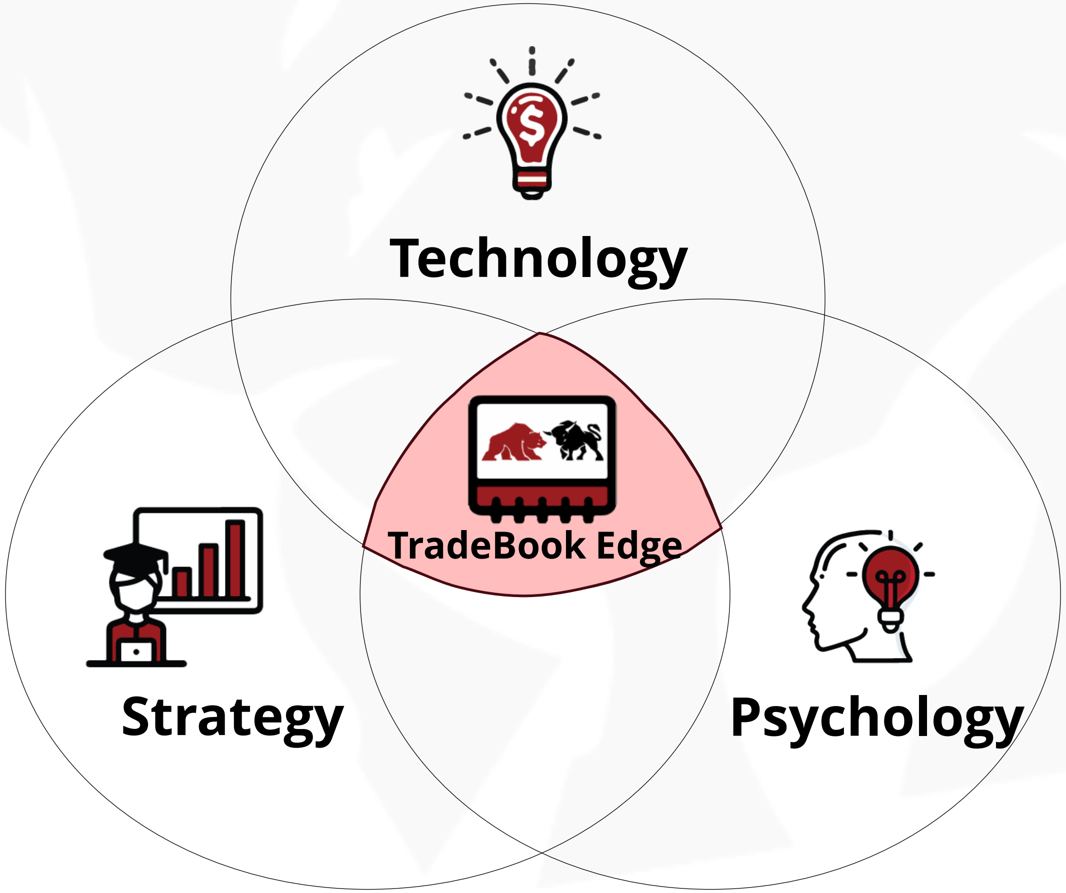
The **5.26%** ’spread’ is known as **the house edge.**

Risk Management

- What is Risk Management?
    - Definition: Process of identifying, assessing and controlling threats to an organization's capital and earnings.
    - In the context of Trading, risk relates to any threat to trading capital.

- Risk Management Framework (RMF)
    - Risk Identification
    - Risk Measurement
    - Risk Mitigation
    - Risk Reporting and Monitoring
    - Risk Governance

- Trading Threats
    - Trader Issues (Core Risks)
        - Technology Knowledge
        - Strategy Knowledge
        - Psychology
        - Physical Well-Being
    - Mechanical Issues (Non-Core Risks)
        - Internet Connection
        - Platform and Data Issues
        - Power Outage
        - Mother Nature



Components of Trade Risk

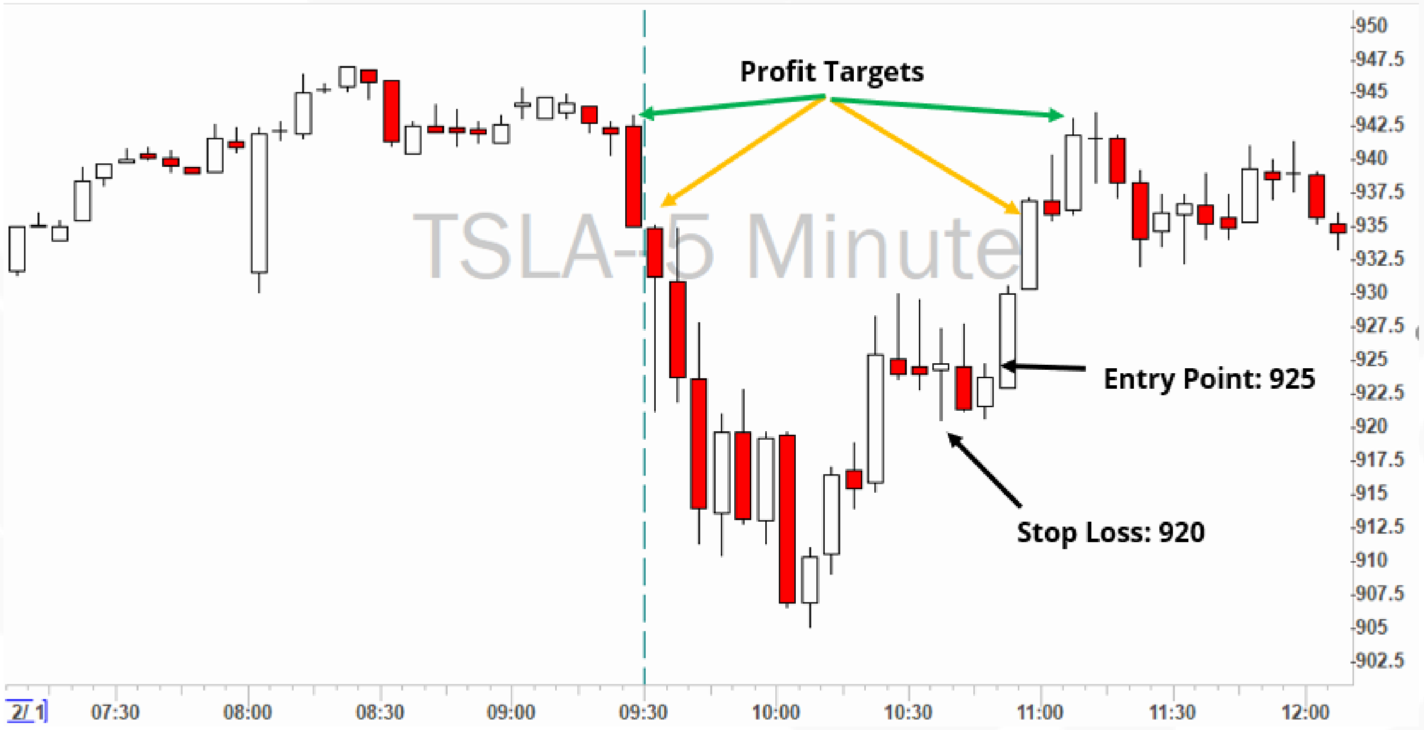
- Trade Risk to Reward (R:R)
  - Entry
  - Stop Loss (Manual and/or Hard)
  - Profit Target(s)
- Share Sizing
  - Fixed Share Size
  - % of Account/Buying Power
  - Fixed Dollar Amount per Trade (R Value)
- Stock Attributes
  - Bid/Ask Spread
  - Average True Range (ATR)
  - Float
  - Intraday Volatility
- Trade Strategy
  - Trade Instrument
  - Setup and Criteria

Trade Risk to Reward

All trades should have clear entry, stop loss, and profit targets defined as you are considering the setup.

Trade Example:

- Entry: 925 (5 Minute High)
- Stop Loss: 920 (Technical Level)
- Profit Target(s)
    - 935 (High of Day / Twice the Risk)
    - 940 (Premarket Area / Triple the Risk)



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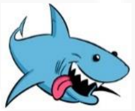
Risk to Reward

Traders find edge by understanding and managing risk as defined by their trade's Risk to Reward Profile.

Risk:Reward = 1:1	Risk:Reward = 1:2	Risk:Reward = 1:3	Risk:Reward = 1:5
Risk = 2%	Risk = 2%	Risk = 2%	Risk = 2%
Reward = 2%	Reward = 4%	Reward = 6%	Reward = 10%
Trades Won = 6	Trades Won = 4	Trades Won = 3	Trades Won = 2
Trades Lost = 4	Trades Lost = 6	Trades Lost = 7	Trades Lost = 8
TotalProfit = 4%	Total Profit = 4%	TotalProfit = 4%	Total Profit = 4%

Share Sizing

Account Threats and Risk Management Rules

- Do not risk more than 1% of your account on any single trade (Shark Bite) 
- Do not allow account to draw down in excess of 7% per block of time (Piranha Bites)

Share Sizing Methods

- Fixed Share Size
    - 100 Shares per trade for stocks priced 25 to 50/share
    - 50 Shares per trade for stocks priced 50 to 100/share
    - 25 Shares per trade for stocks priced 100 to 200/share
- % of Account per Trade
    - Account Size: 10,000
    - Risk per Trade: 1% of Account
    - Total Risk per Trade = 10,000 * .01 = 100/trade
- Fixed Risk Per Trade (R Value)
    - R = 50 meaning every trade risks 50 dollars

Choosing a Share Sizing Method is depending on the trader

Trade Example with Share Sizing

Let's apply various Share Sizing Methods to the previous Trade Example.

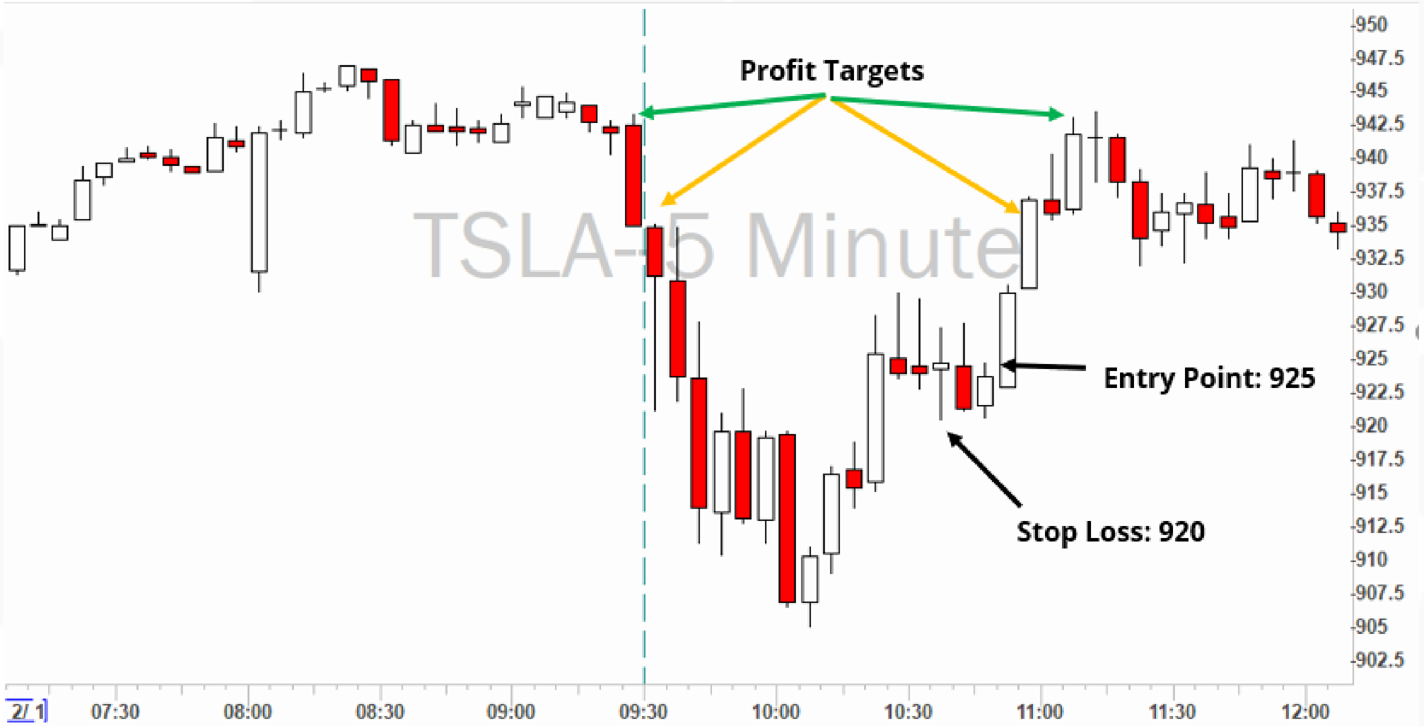
Account Size: 10,000 (40,000 Buying Power)

Stop Loss Range: 5.00

1% of Account: 100

R Value: 50

- Fixed Share Size
    - Max BP: 43 Shares
        - Stop Loss would risk over 1% of account
    - Depends on Trader Criteria
        - 10-20 Shares
- % of Account (1%)
    - 100 per Trade / 5.00 Stop Loss = 20 Shares
- Fixed Risk per Trade (R)
    - 50 per Trade / 5.00 Stop Loss = 10 Shares

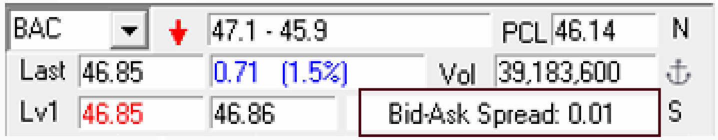


Share Sizing Table

	$10	$25	$50	$75	$100	$125	$150	$200	$250	$300	$400	$500	$600	$800	$1000
$0.05	200	500	1,000	1,500	2,000	2,500	3,000	4,000	5,000	6,000	8,000	10,000	12,000	16,000	20,000
$0.10	100	250	500	750	1,000	1,250	1,500	2,000	2,500	3,000	4,000	5,000	6,000	8,000	10,000
$0.15	67	167	333	500	667	833	1,000	1,333	1,667	2,000	2,667	3,333	4,000	5,333	6,667
$0.20	50	125	250	375	500	625	750	1,000	1,250	1,500	2,000	2,500	3,000	4,000	5,000
$0.25	40	100	200	300	400	500	600	800	1,000	1,200	1,600	2,000	2,400	3,200	4,000
$0.30	33	83	167	250	333	417	500	667	833	1,000	1,333	1,667	2,000	2,667	3,333
$0.40	25	63	125	188	250	313	375	500	625	750	1,000	1,250	1,500	2,000	2,500
$0.50	20	50	100	150	200	250	300	400	500	600	800	1,000	1,200	1,600	2,000
$0.60	17	42	83	125	167	208	250	333	417	500	667	833	1,000	1,333	1,667
$0.75	13	33	67	100	133	167	200	267	333	400	533	667	800	1,067	1,333
$1.00	10	25	50	75	100	125	150	200	250	300	400	500	600	800	1,000
$1.25	8	20	40	60	80	100	120	160	200	240	320	400	480	640	800
$1.50	7	17	33	50	67	83	100	133	167	200	267	333	400	533	667
$1.75	6	14	29	43	57	71	86	114	143	171	229	286	343	457	571
$2.00	5	13	25	38	50	63	75	100	125	150	200	250	300	400	500

Stock Attributes

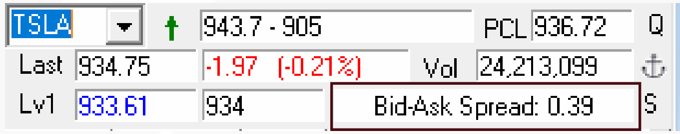
1.20



Index	S&P 500	P/E	12.96	EPS (ttm)	3.56	Insider Own	0.11%	Shs Outstand	8.43B	Perf Week	3.57%
Market Cap	374.32B	Forward P/E	12.19	EPS next Y	3.79	Insider Trans	-2.31%	Shs Float	8.10B	Perf Month	3.62%
Income	30.56B	PEG	0.54	EPS next Q	0.79	Inst Own	72.90%	Short Float	0.93%	Perf Quarter	-3.43%
Sales	47.67B	P/S	7.85	EPS this Y	-32.00%	Inst Trans	0.17%	Short Ratio	1.50	Perf Half Y	21.55%
Book/sh	29.54	P/B	1.56	EPS next Y	16.21%	ROA	0.90%	Target Price	51.32	Perf Year	54.01%
Cash/sh	108.19	P/C	0.43	EPS next 5Y	23.89%	ROE	10.50%	52W Range	29.57 - 50.08	Perf YTD	3.71%
Dividend	0.84	P/FCF	-	EPS past 5Y	7.40%	ROI	7.30%	52W High	-6.27%	Beta	1.37
Dividend %	1.82%	Quick Ratio	-	Sales past 5Y	0.80%	Gross Margin	-	52W Low	58.74%	ATR	1.32
Employees	209000	Current Ratio	-	Sales Q/Q	7.40%	Oper. Margin	89.10%	RSI (14)	54.92	Volatility	3.17% 2.88%
Optionable	Yes	Debt/Eq	2.03	EPS Q/Q	69.00%	Profit Margin	54.90%	Rel Volume	0.76	Prev Close	46.14
Shortable	Yes	LT Debt/Eq	1.11	Earnings	Jan 19 BMO	Payout	23.90%	Avg Volume	50.51M	Price	46.94
Recom	2.40	SMA20	-0.03%	SMA50	2.84%	SMA200	9.43%	Volume	38,541,034	Change	1.73%

Stock Attributes

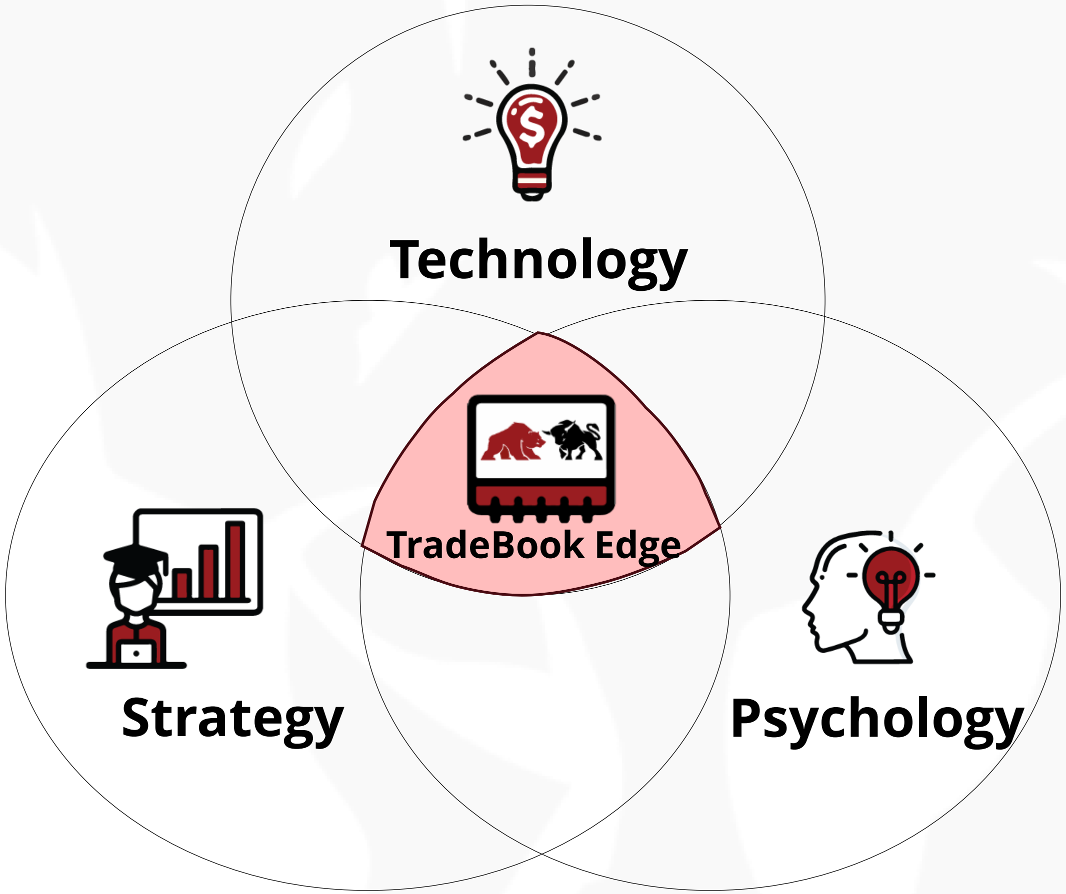
38.7



Index	S&P 500	P/E	191.44	EPS (ttm)	4.89	Insider Own	0.10%	Shs Outstand	1.00B	Perf Week	0.72%
Market Cap	940.71B	Forward P/E	75.80	EPS next Y	12.36	Insider Trans	-94.14%	Shs Float	803.81M	Perf Month	-12.48%
Income	5.52B	PEG	8.82	EPS next Q	2.24	Inst Own	42.30%	Short Float	2.79%	Perf Quarter	-15.91%
Sales	53.82B	P/S	17.48	EPS this Y	165.00%	Inst Trans	-0.42%	Short Ratio	0.79	Perf Half Y	31.99%
Book/sh	27.11	P/B	34.55	EPS next Y	22.32%	ROA	3.90%	Target Price	942.20	Perf Year	11.54%
Cash/sh	16.03	P/C	58.45	EPS next 5Y	21.70%	ROE	8.90%	52W Range	539.49 - 1243.49	Perf YTD	-11.36%
Dividend	-	P/FCF	103.00	EPS past 5Y	19.70%	ROI	4.60%	52W High	-25.11%	Beta	2.04
Dividend %	-	Quick Ratio	1.10	Sales past 5Y	50.80%	Gross Margin	25.30%	52W Low	72.62%	ATR	69.14
Employees	70757	Current Ratio	1.40	Sales Q/Q	56.80%	Oper. Margin	6.10%	RSI (14)	44.42	Volatility	8.85% 6.80%
Optionable	Yes	Debt/Eq	0.30	EPS Q/Q	430.70%	Profit Margin	4.00%	Rel Volume	0.85	Prev Close	936.72
Shortable	Yes	LT Debt/Eq	0.24	Earnings	Jan 26 AMC	Payout	0.00%	Avg Volume	28.55M	Price	931.25
Recom	2.60	SMA20	-7.81%	SMA50	-9.76%	SMA200	14.22%	Volume	24,156,625	Change	-0.58%

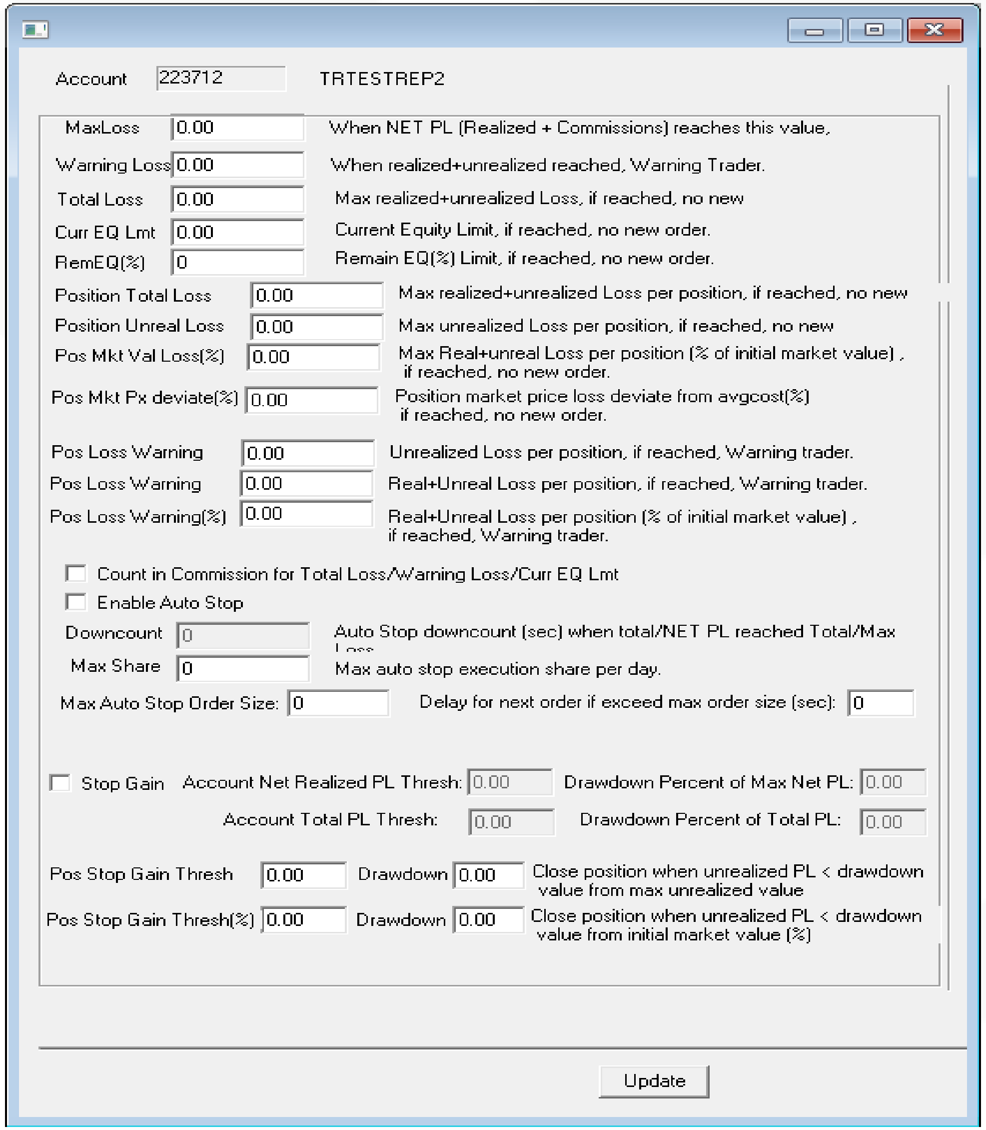
Trade Risk Plan Overview

- I will risk $____ or ____% of my account per trade
  - **$50**
  - **$20**
- I am allowed to scale up my size after ____
  - **After 2 weeks straight of green days**
  - **After two weeks of consistency following my Plan**
- My daily profit target is $____ or ____% of my account
  - **$25**
  - **$50**
- My daily max loss is $____ or ____% of my account
  - **$50**
  - **$60**
- I am allowed to take a max of ____ trades per day
  - **3**
  - **3**



Mechanical Risk Management

- Mechanical Issues
  - Internet Connection
  - Platform and Data Issues
  - Power Outage
  - Mother Nature
- Tools & equipment you have for an emergency
  - Generator
  - Backup Computer and Peripherals
  - Phone
  - **Platform Risk Controls**



Physical Risk

Corresponds to physical impairment due to activities within the Trader's control.

- Sleep Deprivation
- Hunger/Dehydration
- Air Flow Conditions
- Hangover from Controlled Substances

- Having a Risk Management Plan in place when your physical condition is at risk for trading can prevent poor performance and additional stress when unnecessary.

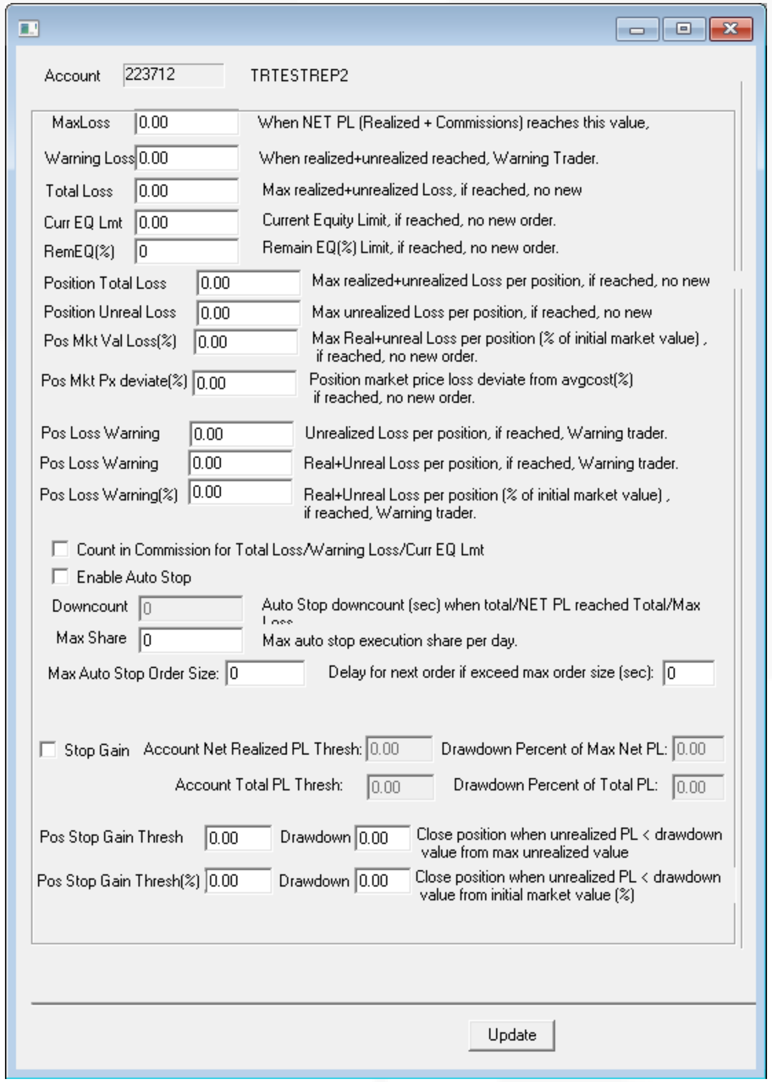
Platform Risk Controls

Most Trading Platforms have ways to enter Loss Thresholds that can act as a Safety Net for unexpected events.

Mitigates various types of risk

- Mechanical Risk
- Psychological Risk
- Uncategorized Risk

Traders can blow up accounts in as little as a single trade without these in place.



Risk Management Example

- Threat: Power Outage during Live Trading
- Risk Identification:
  - Type of Risk: Mechanical
  - Core Risk?: No
- Risk Measurement:
  - Frequency: Rarely (<1/month)
  - Exposure: Low (Other Risk Mitigation will Trigger)
- Risk Mitigation:
  - Generator to restore power
  - Mobile Platform to manage active trades
  - Time Spent waiting for Power Restoration
- Risk Reporting:
  - Journal event as a note in Trading Journal
  - Ensure Threat Frequency isn't concentrated

Risk Management Example

- Threat: Lack of Strategy Trading Reversals
- Risk Identification:
  - Type of Risk: Trader – Strategy
  - Core Risk?: Yes
- Risk Measurement:
  - Frequency: Daily
  - Exposure: Depends on Trader Discretion
- Risk Mitigation:
  - SIM Trading for Practice and Development of Trade Book Criteria for Strategy
  - Live Trading using Smaller Risk per Trade
  - Lower % of Total Trades until Performance Objectives are Met
- Risk Reporting:
  - Journaling Performance for trades
  - Reviewing Trades actively to adjust expectations

Resources

Bear Bull Trader Education Center: https://bearbulltraders.com/education-center/

- Risk Management Webinars
- DAS Risk Controls
- DAS Hotkeys

Bear Bull Traders Downloads: https://bearbulltraders.com/course/downloads/

- Technology Documents
- Strategy Documents
- Psychology Documents