

Money Management – Market Mover Edge Style

By: Tim Barnby

We teach, and I personally and professionally use, Capital Based money management. People are superstitious. We think we have a \$10,000.00 account even after a 30% draw down. We always try to **swing a big line**, no matter what our condition is. Even worse is the poor guy who has to “get back” at GBPJPY for the 300 pip loss he took in the previous trading session. A trader can’t get back at the market. The market is bigger than all of us, and it’ll take what ever we offer it, whenever it wants. The idea behind money management is to not offer her much (even less when we’re losing) and take more from her when she’s generous. Proper money management will protect you from yourself. Money management is no different from everything else in the trading profession. It’s a series of steps that are taken every single time you trade. When I wake up in the morning I put on my pants before I step out the door. When I get in the car, I put the key in before I drive away. When I open a trade, I follow my money management steps. It’s that routine. It’s so routine that it requires absolutely NO THOUGHT! No deliberation, no self-negotiation. There are no exceptions to trading rules. I view trading rules much like I approached combat in the Army. Exceptions get you killed! Excuse yourself one time from following your rules and your blood will be sprayed all over the room. Get it? Do you see how important it is to follow these rules? Just in case you didn’t get this earlier, I’ll say it again here: There are no exceptions to money management rules. If you break your money management rules, I’m going to be spending ALL of your money instead of a little bit of it. Remember that every trader in the market wants you to lose. It is a market. We’re traders, not investors. We make a living speculating on supply and demand. Even the best system has long periods of draw down.

Here are your rules. This, above all else, will save your butt!

1. When you begin trading, risk only 2% of your base capital.
2. Reduce your base capital by 5% for each open trade.
3. After 3 consecutive winners, increase your risk to 4% of your base capital.
4. After 1 loss, reduce risk to 2% of base capital.
5. After two consecutive losses, reduce risk to 1.5% of base capital.
6. After four consecutive losses, reduce risk to 1% of your base capital.
7. After two consecutive wins, we reset back to 2% risk per capital and move back to step one.

Example – (Modified percentages)

Trade Journal – Week of 13 Oct, 2008								
Risk	Pair	Risk	Equity	Win	Loss		Per Pip	Win/Loss
0.03	USDJPY	\$300.00	\$10,000.00	60	30		\$10.00	\$600.00
0.03	EURUSD	\$318.00	\$10,600.00	60	30		\$10.60	\$636.00
0.03	GBPUSD	\$337.08	\$11,236.00	60	30		\$11.24	\$674.16
0.045	GBPUSD	\$535.95	\$11,910.00	60	30		\$17.87	\$1,071.90
0.045	GBPUSD	\$584.15	\$12,981.00	60	30		\$19.47	\$584.15
0.03	USDJPY	\$369.87	\$12,329.00	60	30		\$12.33	\$369.87
0.015	EURUSD	\$179.39	\$11,959.00	60	30		\$5.98	\$179.39
0.015	EURUSD	\$176.69	\$11,779.00	60	30		\$5.89	\$353.37
0.015	EURUSD	\$181.98	\$12,132.00	60	30		\$6.07	\$363.96
0.03	GBPUSD	\$374.85	\$12,495.00	60	30		\$12.50	\$749.70
0.03	USDCAD	\$397.32	\$13,244.00	60	30		\$13.24	\$397.32
0.015	EURUSD	\$192.69	\$12,846.00	60	30		\$6.42	\$192.69
0.015	GBPUSD	\$189.80	\$12,653.00	60	30		\$6.33	\$189.80
0.015	USDJPY	\$186.95	\$12,463.00	60	30		\$6.23	\$186.95
0.015	EURUSD	\$184.14	\$12,276.00	60	30		\$6.14	\$368.28
0.015	EURJPY	\$189.66	\$12,644.00	60	30		\$6.32	\$379.32
0.03	EURJPY	\$390.69	\$13,023.00	60	30		\$13.02	\$781.38
0.03		\$414.12	\$13,804.00					
Performance								
Winners	Losers		AW	AL		PW	PL	Edge
11	6		60	30		0.647059	0.35	28
Largest Drawdown								
\$966.75								

The example shows how we manage losing streaks. This example illustrates a very good system. A system that has a 2:1 reward/risk ratio with a 65% win rate is truly rare. At that reward/risk ratio you only need a 33% win rate to break even if you steadily trade the same amount. When you reduce your risk while on a losing streak, you can remain profitable even below a 33% win rate. You can see the power of proper money management.

Contrast this scenario with the trader who, by some miracle, wins those first five trades. When a non-professional trader is on a winning streak, he tends to attribute it to his trading genius. The next Jesse Livermore gets five winning trades and is now a guru... This is the point where he makes a fatal mistake. He places a trade... a big trade. He takes his \$13,000.00 and puts on 5 standard lots. Why not? He is a Rock Star trader now... a real veteran. Price turns against him by 20 pips. He can't stand the thought of losing \$1,000.00 in five short minutes, so he moves his stop loss. He fools himself into thinking that he made the right trade. The market is just acting wrong. It'll turn around

for sure. Another 20 pips should do it. An hour later, price is almost to his new stop loss. He's now about to lose \$2,000.00. He can't lose. The market will turn around. He moves the stop loss back by another 100 pips this time. He goes to bed knowing his position is safe. It'll never move another 100 pips against him. After all, the 15 Minute trend IS Bullish and the 5 Minute stochastic is already almost over-sold, and the MACD is clearly in an up-trend. He can almost smell the leather in the new Porsche he'll buy with the winnings from this massive trade. He wakes up and rushes to his computer. He sees that his trade is closed out...his new balance is \$5,000.00. He sees that he's gotten a margin call. All that he has left is the money that he had leveraged. Don't laugh. I know the guy that this exact scenario happened to. He's since become an excellent trader.

If the same trader had used sound money management and risked 3%, he'd have hit that 20 pip stop loss and easily swallowed the \$400 or so loss. His mistake was what I call "trading beyond the sleeping level." If you find yourself worrying about a trade, you're risking too much. Let me make sure you understand that...if you cannot sleep, go to dinner with your spouse, go golfing, or spend 6-8 hours doing whatever without thinking about your open trades, you're risking too freaking much money! You MUST Trade down to the sleeping level. Your success as a trader depends on this. There will be future articles on the mental game of trading. I just told you the secret of the mental game though. ☺