

BUSINESS FINANCIAL SAFETY

RISK MANAGEMENT

PROTECTION ANALYSIS

CONTROL STRATEGY

Introduction

It is generally noticed that when we invest or trade our focus is on potential gains rather than dwelling on possible losses.

Traders are often so confident about their trades that they push back their minds and don't think that something could go wrong.

But in order to be successful trader, we must keep our mind open to the potential losses and we should know how to manage and control those losses.

Five Steps of Risk Management Process



RISK

PROMOTION

STRATEGY

ORGANIZATION

RESOURCES

PLAN SOLUTION

TARGET

RISK

COMPANY

RESEARCH

ONLINE

PRODUCT

ASSESSMENT

SALES

CUSTOMER

PLAN

RETENTION

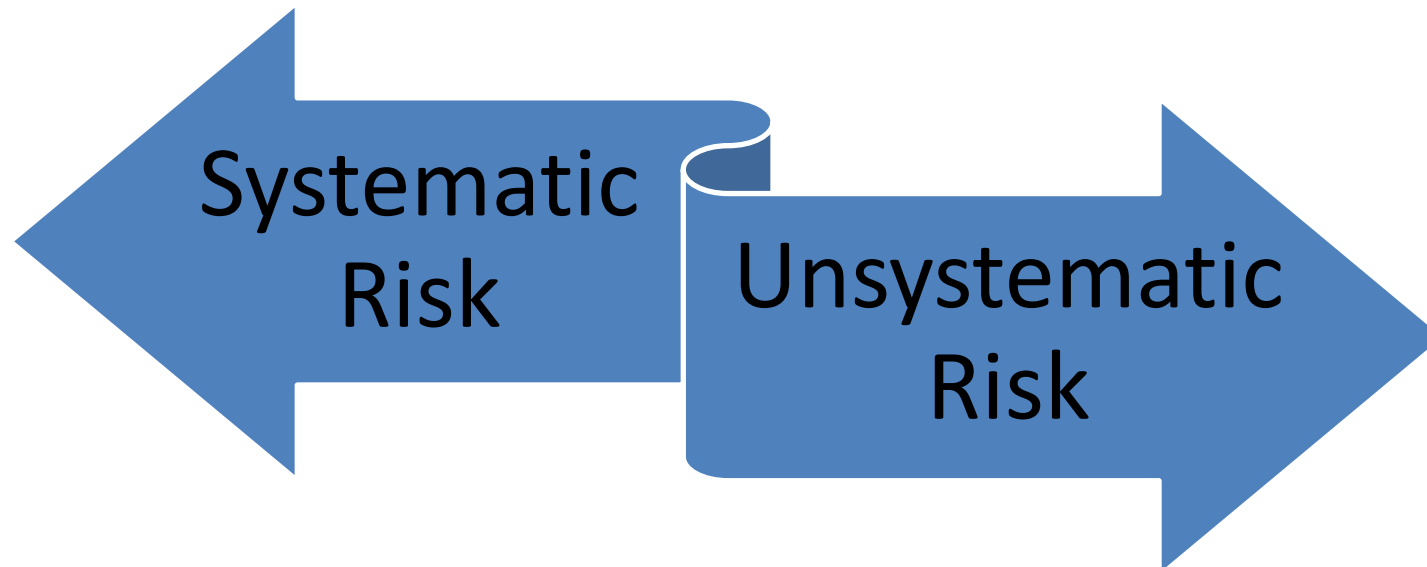
BUSINESS

MANAGEMENT



Risk

- The chance that an investment's actual return will be different than expected return.
- The possibility of losing some or all of the investment.
- "Risk is a chance of loss."



Risk

- Risk takes on many forms but is broadly categorized as the chance an outcome or investment's actual gain will differ from the expected outcome or return.
- Risk includes the possibility of losing some or all of an investment.
- There are several types of risk and several ways to quantify risk for analytical assessments.
- Risk can be reduced using diversification and hedging strategies.

Systematic Risk

- Risk that are applicable to the entire economy & market.
- An unavoidable , Uncontrollable in nature.
- Influenced by External Factors.
- Macro in Nature.



Unsystematic Risk

- Risk that are applicable to the Organisation.
- An Avoidable , Controllable in nature.
- Influenced by Internal Factors.
- Micro in Nature.





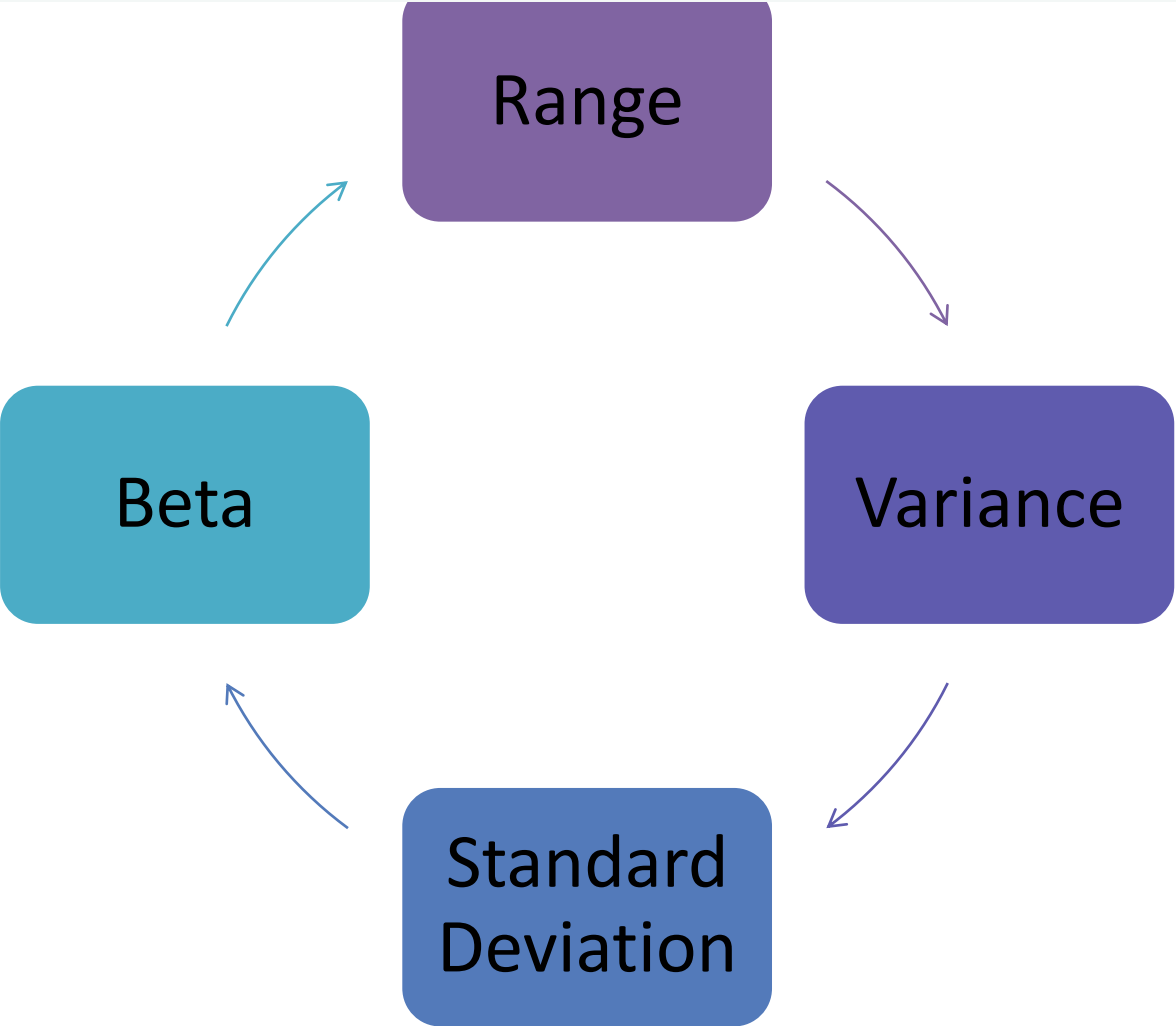
Systematic
Risk

VS



Unsystematic
Risk

BASIS FOR COMPARISON	SYSTEMATIC RISK	UNSYSTEMATIC RISK
Meaning	Systematic risk refers to the hazard which is associated with the market or market segment as a whole.	Unsystematic risk refers to the risk associated with a particular security, company or industry.
Nature	Uncontrollable , Non Diversifiable, Unavoidable	Controllable , Diversifiable , Avoidable
Factors	External factors	Internal factors
Affects	Large number of securities in the market.	Only particular company.
Types	Interest risk, market risk and purchasing power risk.	Business risk and financial risk
Protection	Asset allocation	Portfolio diversification



Range

- Difference between the low & high prices of security.
- Price Spread

Variance

- The process of weighing risk against expected returns.
- Measurement of the spread between numbers in a data set from the mean.

Standard Deviation

- Its a square root of variance.
- Measures the dispersion of data from its expected value.

Beta

- A measure of volatility/ systematic risk of a security.
- Market Beta 1.0
- High Beta : More Riskier , Lower Beta : Less Riskier

RETURN

- The Gain or Loss of a security in a particular Period is known as Returns.
- Returns consists of the income & capital gains.
- Quoted as a Percentage.



Returns

A return is the change in price on an asset, investment, or project over time, which may be represented in terms of price change or percentage change.

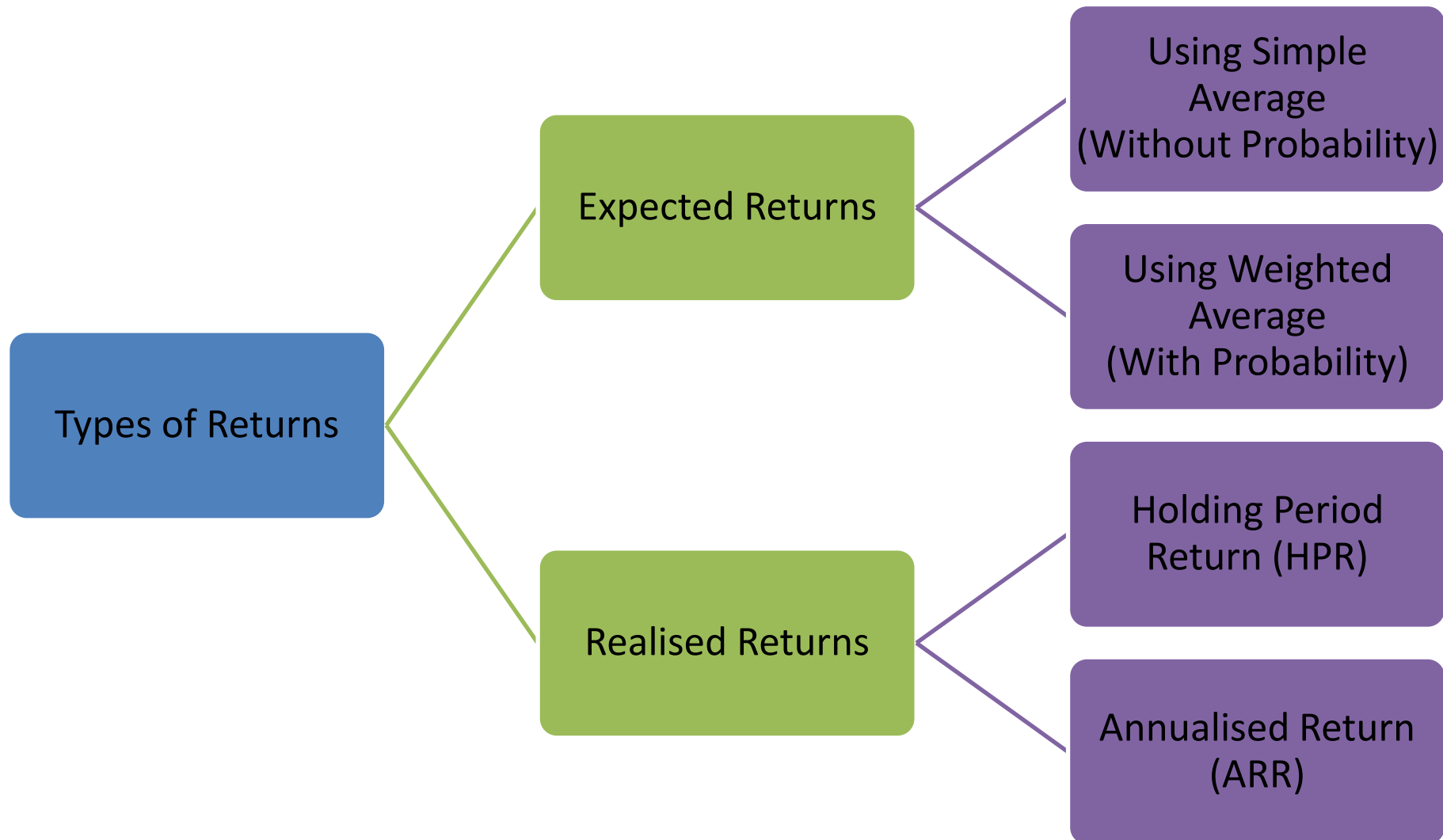
A positive return represents a profit while a negative return marks a loss.

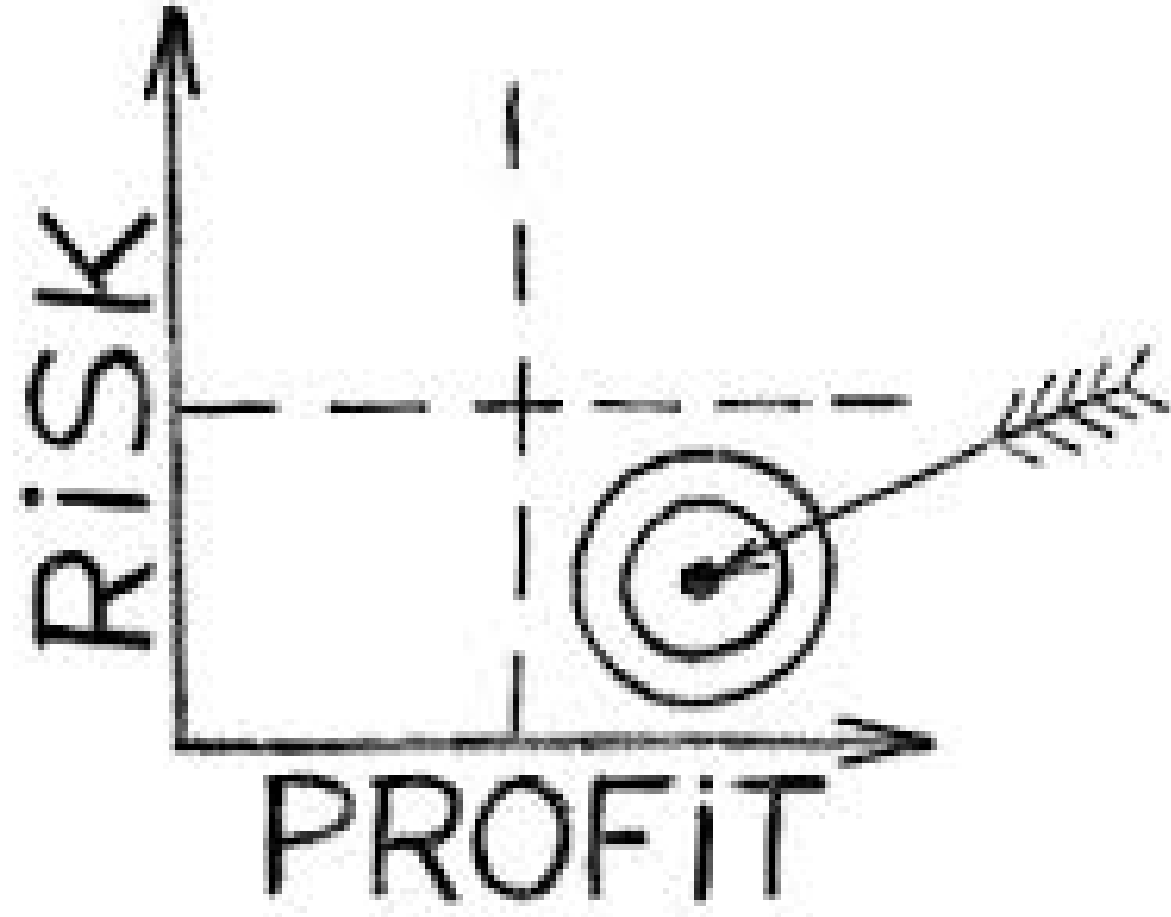
Returns are often annualized for comparison purposes, while a holding period return calculates the gain or loss during the entire period an investment was held.

Real return accounts for the effects of inflation and other external factors, while nominal return only is interested in price change. Total return for stocks includes price change as well as dividend and interest payments.

Several return ratios exist for use in fundamental analysis.

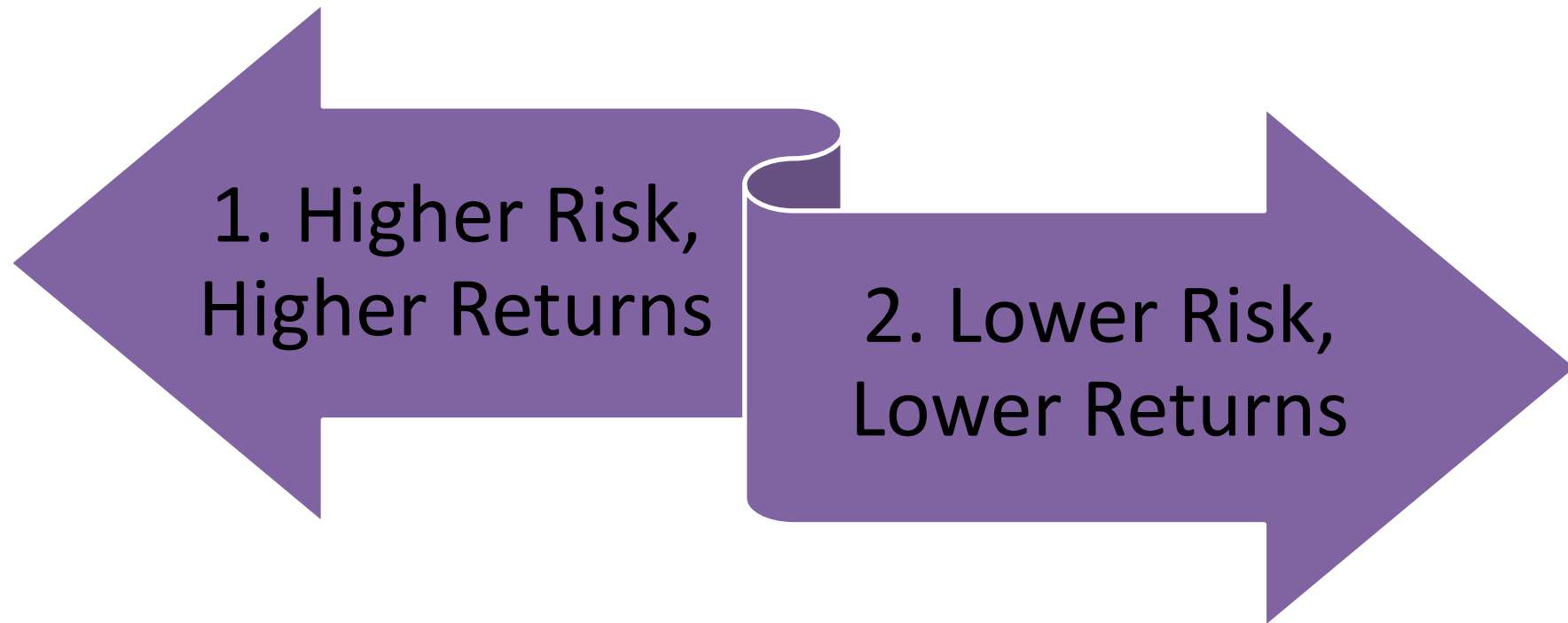
Types of Returns





Risk Return Relationship

- Risk & Returns are the Two sides of the same Coin.



Risk Return Relationship

The risk Return Trade Off determines how aggressive an investor want to be with the assets included in portfolio.

The Risk Return Trade Off is an important element of Modern Portfolio Theory.

It finds out Optimum Mix of Assets.

Evaluate relationship based on Time Horizon & Levels of risk tolerance of Investor.

Risk Return Relationship

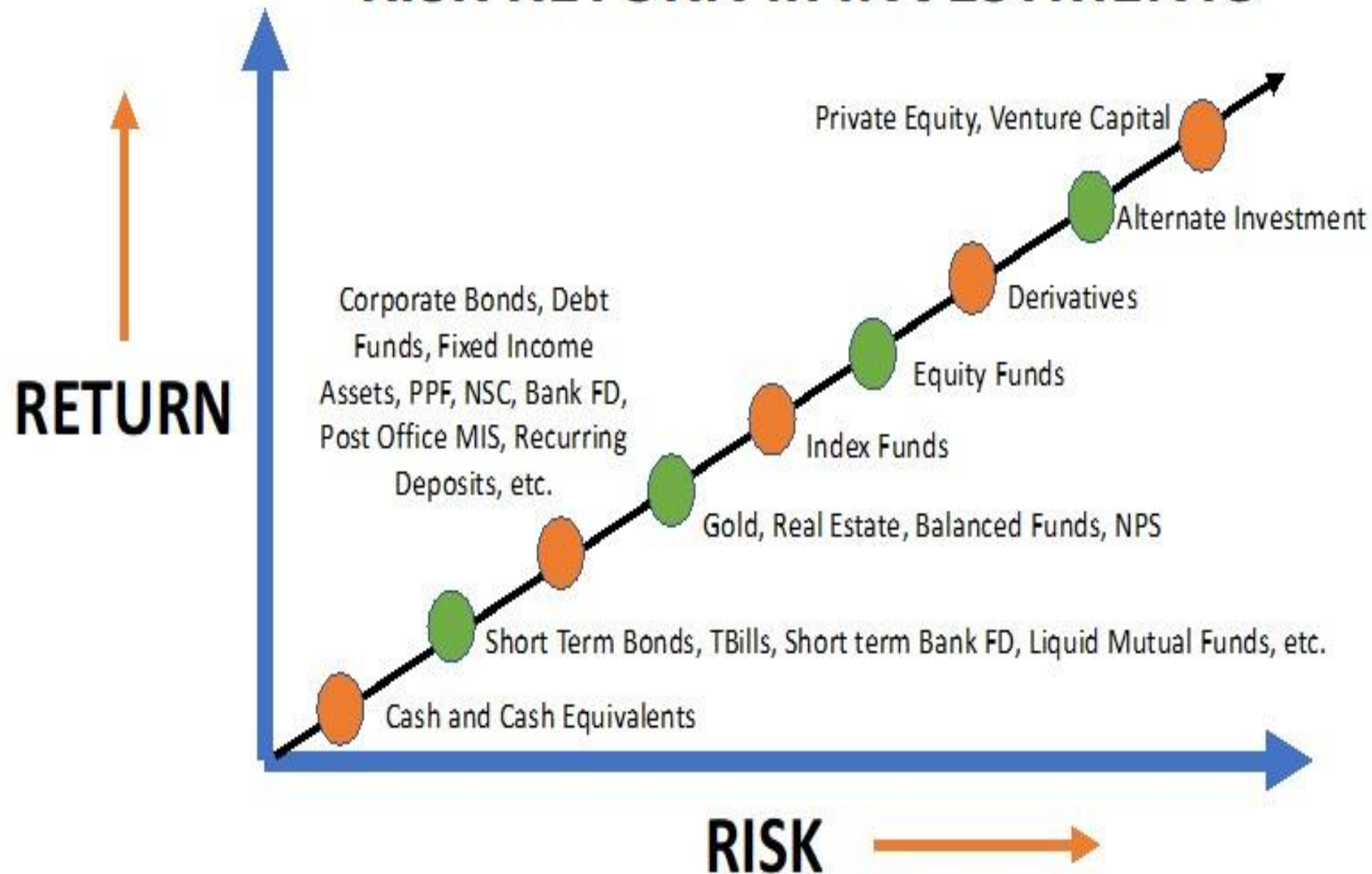
The risk-return tradeoff is an investment principle that indicates that the higher the risk, the higher the potential reward.

To calculate an appropriate risk-return tradeoff, investors must consider many factors, including overall risk tolerance, the potential to replace lost funds and more.

Investors consider the risk-return tradeoff on individual investments and across portfolios when making investment decisions.



RISK RETURN in INVESTMENTS



Reduction of Risk through Diversification

“There is a close logical connection between the concept of a safety margin and the principle of diversification.”- Benjamin Graham

Diversification : Technique of reducing risk by allocating investments among various financial instruments / industry and category.

Diversification does not guarantee against loss.

Reasons for Diversification

- Reducing risk
- Gaining experience

- Make more money
- Discipline

- Different investment styles
- Provides more opportunity
- Limits bias

Principles of Diversification

01

- A single company investment is more risky than two companies.

02

- A single industry investment is more risky than two industry.

03

- Two companies or industry which are similar in nature of demand or make are more risky than two in dissimilar companies or industry.

04

- The diversification is proper which involves two or more companies r industries whose fortunes fluctuate independent of one another or in different directions.

Methods / Way for Diversification



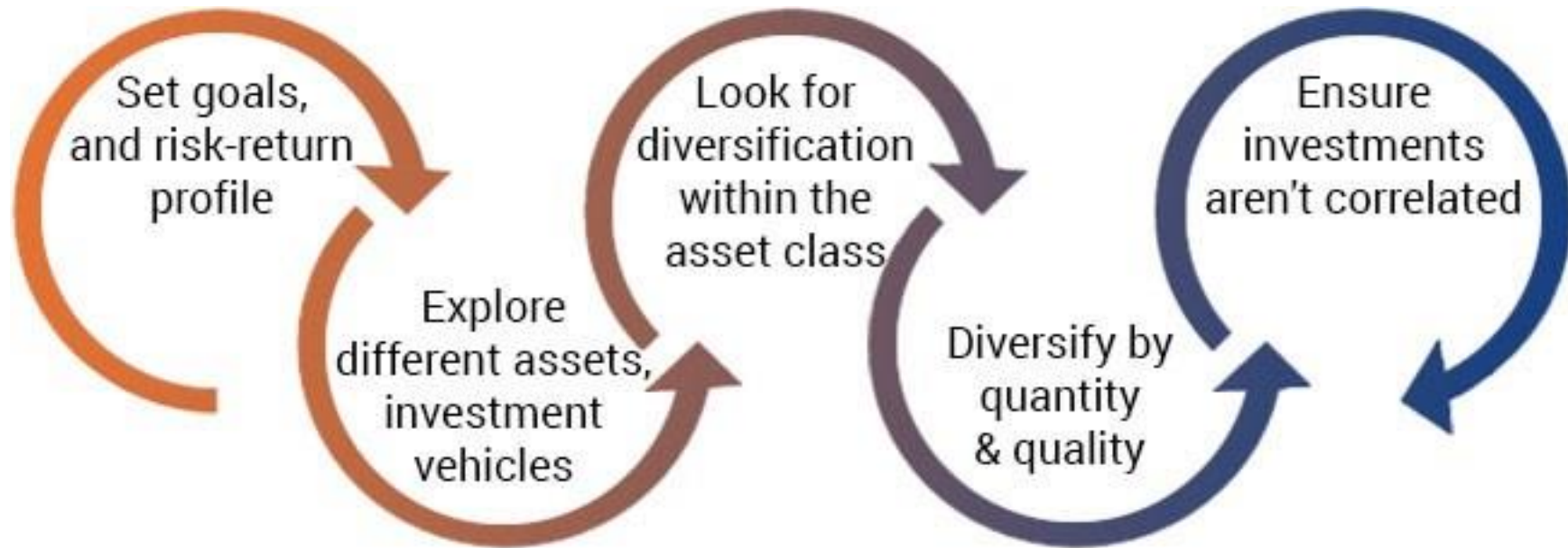
Changing the type of Assets.

Changing the type of Instrument.

Changing the Industry.

Changing the Companies.

How to diversify your portfolio?



If you are making huge profits in the market on a very small or average trading account, it is most likely that you are not implementing sound money management.

Maybe you are lucky for one or two days that has earned you windfall profits.

But you have exposed yourself to obscene risk because of an abnormally high "Trade Size."

If you continue trading in this manner, probabilities indicate that very soon you would land up with series of losses and you may lose your entire capital.

Trading, like every other business, needs to start with a certain amount of equity or “seed capital”.

Traders remain in business so long as they have this seed capital with them.

Many traders start and end their trading capital in just one month!

By not controlling risk and by using improper “Trade Size” a trader can go broke in no time.

It usually happens like this; they begin trading, get 5 to 8 losses in a row, don't use proper position size and don't cut their losses soon enough.

After 5 to 8 devastating losses in a row, their funds become too small to continue trading.

Novice traders tend to focus on the trade outcome as only winning and therefore do not think about risk.

They don't ask themselves, how much can they afford to lose on this trade and hence they fall prey to the "risk-of-ruin" outcome.

Failure to implement good money management program will leave you subject to the deadly "risk of ruin" exposure leading eventually to a probable equity bust.

Professional traders focus on the risk and take the trade based on a favourable outcome.

Thus, the psychology behind ‘Trade Size’” begins when you believe and acknowledge that each trade’s outcome is unknown when entering the trade.

You either adjust your “Trade Size” or tighten your stop-loss before entering the trade.

In most situations, the best method is to adjust your “Trade Size” and set your stop-loss based on market dynamics.

During “draw-down” periods, risk control becomes very important and since good traders test their trading systems, they have a good idea of the probabilities of how many consecutive losses in a row can occur.

Taking this information into account, allows the trader to further determine the appropriate risk percentage to take on each trade.

The idea behind money management is that given enough time, even the best trading systems will only be right about 60% to 65% of the time.

That means 40% of the time we will be wrong and have losing trades.

For every 10 trades, we will lose an average of 4 times.

Even certain trading set ups with higher rates of returns nearing 80% usually fall back to a realistic 60% to 65% return when actually traded.

The reason for this is that human beings trade trading systems.

And when human beings get involved, the rates of returns on most trading systems are lowered.

Why? Because humans make trading mistakes, and are subject from time to time to emotional trading errors.

If we are losing 40% of the time then we need to control risk! This is done through implementing stops and controlling position size.

We never really know which trades will be profitable.

As a result, we have to control risk on every trade regardless of how sure we think the trade will be.

If our winning trades are higher than our losing trades, we can do very well with a 60% trading system win to loss ratio. In fact with risk control, we can sustain multiple losses in a row without it devastating our trading account and our emotions.

Risk Management

- Risk is there in every business and proper risk management is road to success for any business.
- Equity trading is a lucrative business which is very rewarding but this reward is not risk free, as theoretically and practically risk free trade does not exist.
- Because risk is associated with the reward, it becomes essential to manage risk in order to protect one's capital.

Risk management is very essential for trading as markets have potential to take back all life time profits in just few bad trades.

Risk managements help in preserving initial capital and accumulated profits so that one can stay alive long enough in financial markets for wealth creation, thus it provides biggest edge in trading.

Components of risk management

- ***Stop loss***

- Stop loss is an integral part of risk management. Stop loss is an order placed to buy or sell security once certain price is reached.
- It is basically designed to limit the amount of loss on buy/sell position.
- In fact by placing the stop loss one is just closing the losing position and limiting the amount of loss which can increase beyond imagination.

- ***Analyze reward risk ratio***

- Before initiating a trade, the trade should analyze reward risk ratio. On a conservative basis if the said ratio is less than 1.5 then one should not initiate the trade.

- ***Trail stop loss***

- Initially stop loss is placed to protect one's capital on a losing trade, but once the trade is in profit stop loss should be so moved that trade is at zero risk even if trailed stop loss gets triggered.

- ***Booking profit***

- Profit is the only goal for which we all trade. But at the same time profit is profit only when it is realized otherwise its notional profit.
- Hence one should book profit at predefined target levels and one should not be carried away by one's emotions specially greed when prices are near to predefined target levels.

- ***Use of stop loss***

- A trader should always put Stop Loss and trade a fraction of his capital.
- It is very important for the trader to have sound knowledge in the area concerned and should be comfortable with the trading system.
- He should be aware that it is possible and inevitable to have a losing streak of five losses in a row. This is called drawdown.
- This awareness will help the traders prepare as to how to control risk and choose their trading system.
- What we are striving for is a balanced growth in the trader's equity curve over time.

- ***Qualities of successful traders:***

1. Always use stops
2. Trade size should be determined on the basis of trading account equity, and stop loss price for every trade.
3. Never trade more than 10% on any give sector
4. Never exceed a loss of 2 to 5% on any given trade
5. Always trade with risk capital, money you can afford to lose.
6. Never trade with borrowed money and don't overtrade based on the time frame you have chosen to trade

Golden rules for traders

- **Want to trade successfully?**

- It is very important to choose good positions over the bad ones. Poor trading sense leads to a heavy loss of both the confidence and money.
- Without a system of discipline for your decision-making, impulse and emotion will undermine skills as you chase the wrong stocks at the worst times.

- **Many short-term players view trading as a form of gambling.**
- Many short-term players without planning or discipline jump in the market.
- The occasional big score reinforces this easy money attitude but sets them up for ultimate failure.
- Without defensive rules, insiders easily feed off these losers and send them off to other hobbies.
- **Technical Analysis teaches traders to execute positions based on numbers, time and volume.**
- This discipline forces traders to distance themselves from reckless gambling behavior.
- Through detached execution and solid risk management, short-term trading finally “works”.

Do's and Don'ts in trading

- 1. Forget the news, remember the chart. You're not smart enough to know how news will affect price. The chart already knows the news is coming.
- 2. Buy at support, sell at resistance. Everyone sees the same thing and they're all just waiting to jump in the pool.
- 3. Don't chase momentum if you can't find the exit. Assume the market will reverse the minute you get in. If it's a long way to the door, you're in big trouble.
- 4. Trends test the point of last support/resistance. Enter here even if it hurts.

- 5. Trade with the TICK not against it. Don't be a hero. Go with the money flow.
- 6. If you have to look, it isn't there. Forget your college degree and trust your instincts.
- 7. The trend is your friend in the last hour. As volume cranks up at 3:00pm don't expect anyone to change the channel.
- 8. Avoid the open.
- 9. Bulls live above the 200 day, bears live below. Sellers eat up rallies below this key moving average line and buyers to come to the rescue above it.

- 10. Price has memory. What did price do the last time it hit a certain level? Chances are it will do it again.
- 11. Big volume kills moves. Climax blow-offs take both buyers and sellers out of the market and lead to sideways action.
- 12. Trends never turn on a dime. Reversals build slowly. The first sharp dip always finds buyers and the first sharp rise always finds sellers.
- 13. Bottoms take longer to form than tops. Greed acts more quickly than fear and causes stocks to drop from their own weight.
- 14. Beat the crowd in and out the door. You have to take their money before they take yours, period.

Rules to Stop Losing Money

- 1. Don't trust others opinions - It's your money at stake, not theirs. Do your own analysis, regardless of the information source.
- 2. Don't break your rules - You made them for tough situations, just like the one you're probably in right now.
- 3. Don't try to get even - Trading is never a game of catch-up. Every position must stand on its merits. Take your loss with composure, and take the next trade with absolute discipline.
- 4. Don't believe in a company - Trading is not investment. Remember the charts and forget the press releases.
- 5. Don't seek the Holy Grail - There is no secret trading formula, other than solid risk management. So stop looking for it.

- 6. Don't forget your discipline - Learning the basics is easy. Most traders fail due to a lack of discipline, not a lack of knowledge.
- 7. Don't trade over your head - Concentrate on playing the game well, and don't worry about making money.
- 8. Don't chase the crowd - Listen to the beat of your own drummer. By the time the crowd acts, you're probably too late...or too early.
- 9. Don't trade the obvious - The prettiest patterns set up the most painful losses. If it looks too good to be true, it probably is.
- 10. Don't ignore the warning signs - Big losses rarely come without warning. Don't wait for a lifeboat to abandon a sinking ship.

- 11. Don't count your chickens - Profits aren't booked until the trade is closed. The market gives and the market takes away with great fury.
- 12. Don't forget the plan - Remember the reasons you took the trade in the first place, and don't get blinded by volatility.
- 13. Don't join a group - Trading is not a team sport. Avoid acting on messages, flashes and financial TV. Your judgment may be more correct than all of them put together
- 14. Don't have a pay check mentality - You don't deserve anything for all of your hard work. The market only pays off when you're right, and when your timing is really, really good.
- 15. Don't ignore your intuition - Respect the little voice that tells you what to do, and what to avoid. That's the voice of the winner trying to get into your thick head.

- 16. Don't hate losing - Expect to win and lose with great regularity. Expect the losing to teach you more about winning, than the winning itself.
- 17. Don't fall into the complexity trap - A well-trained eye is more effective than a stack of indicators. Some time Common sense is more valuable than a complex set of indications.
- 18. Don't confuse execution with opportunity - Overpriced software won't help you trade like a pro. Pretty colours and flashing lights make you a faster trader, not a better one.
- 19. Don't project your personal life - The outcome of your trade is definitely likely to get affected by the situation at your home. Get your own house in order before playing the markets.
- 20. Don't think its entertainment - Trading should be boring most of the time, just like the real job you have right now.

- If one could sum up the single most important aspect of successful trading it would be to stick with the trend as much as possible.
- ***“The Trend is your friend until the end when it bends.”***
Anonymous

Trading Psychology

- “The Trend is your Friend.”
- Trading with trend is not just another axiom that rolls off the lips of traders, but it is the very core of successful trading.
- There are infinitely better opportunity to trade with the trend then against it.
- Human Nature / Psychology.
- Individualism & Crowd strategy.

- Market reactions & patterns.
- Trade with trend until it hurts.
- A good entry or a good exit?
- Components : Market Analysis, Money Management & Mental Attitude.
- The difference is the emotional impact trading has on us, when we trade with real money.
- Emotion has impact on trading decisions & strategy.
- Its became difficult to stick to original plan, once emotion surface.

Relieving Trading Stress Plans



Importance of Discipline in Trading

- Overtrading is the biggest reason for failure of people in trading. While there is no definitive rule for how many times you can (or should) trade, new traders should be especially cautious not to overtrade.
- Industry statistics show that 90% of new traders will not make it to their first anniversary.
- Why? Overtrading is one factor that has been identified as a definite 'no-no'.

So why do traders overtrade?

- Traders overtrade because of the reason that they are hooked on the rush that comes from being in the markets.
- Some overtrade because they feel they will miss a golden opportunity if they don't trade.
- Some traders overtrade because their system does not have specific enough entry criteria to keep them out of bad trades.
- Many traders in a hurry to start trading don't wait for a good opportunity but start trading with a first trade that looks good.
- Some traders overtrade because they feel that the more they trade, more the money they will be able to make.

learning to identify the best market opportunities.

- There are three positions that a trade can have in the market namely: long, short or flat.
- But the trader's don't realize this. Many of them feel that they have to be constantly in the market for which they need to acquire either a long position or a short position.
- It is equally important to recognize that the third option, being flat, is as legitimate a position as the first two.
- Being flat allows you to watch the market set up so that you can best take advantage of the market when it is ready.
- This is what traders mean when they tell you *not to chase the markets.*

- It is important to learn to wait for the markets and let them come to you.
- Then your job as a trader is to be ready for them.
- Buy, sell, or stand aside. Just make sure it's the right decision at the time.
- There are many methods to build superior trading habits.
- Good trading habits will make trading a part of routine, rather than a task. Getting in the habit of doing everything exactly to plan will boost trading profits, marking one more step in the path to financial freedom.

Trading
Discipline

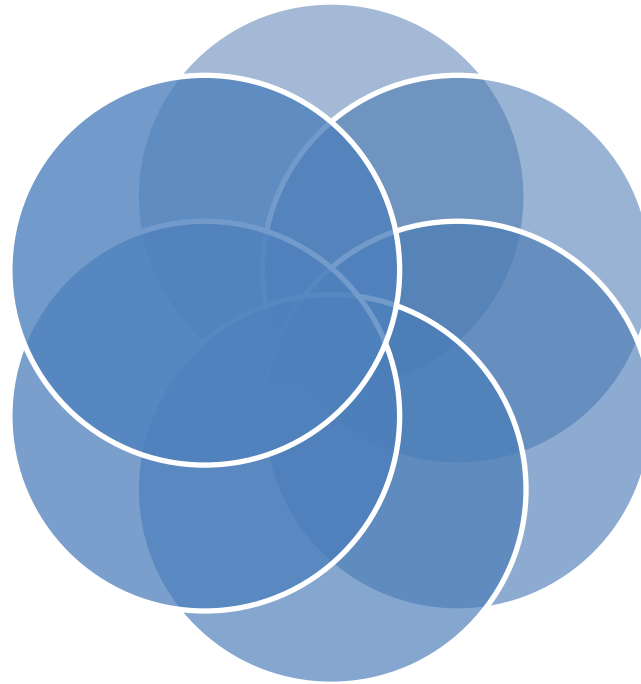
Understanding
Risk

Trade as your
capital allows

Trading is
affected by
emotion

Stick to your
Niche

Look at every
time frame



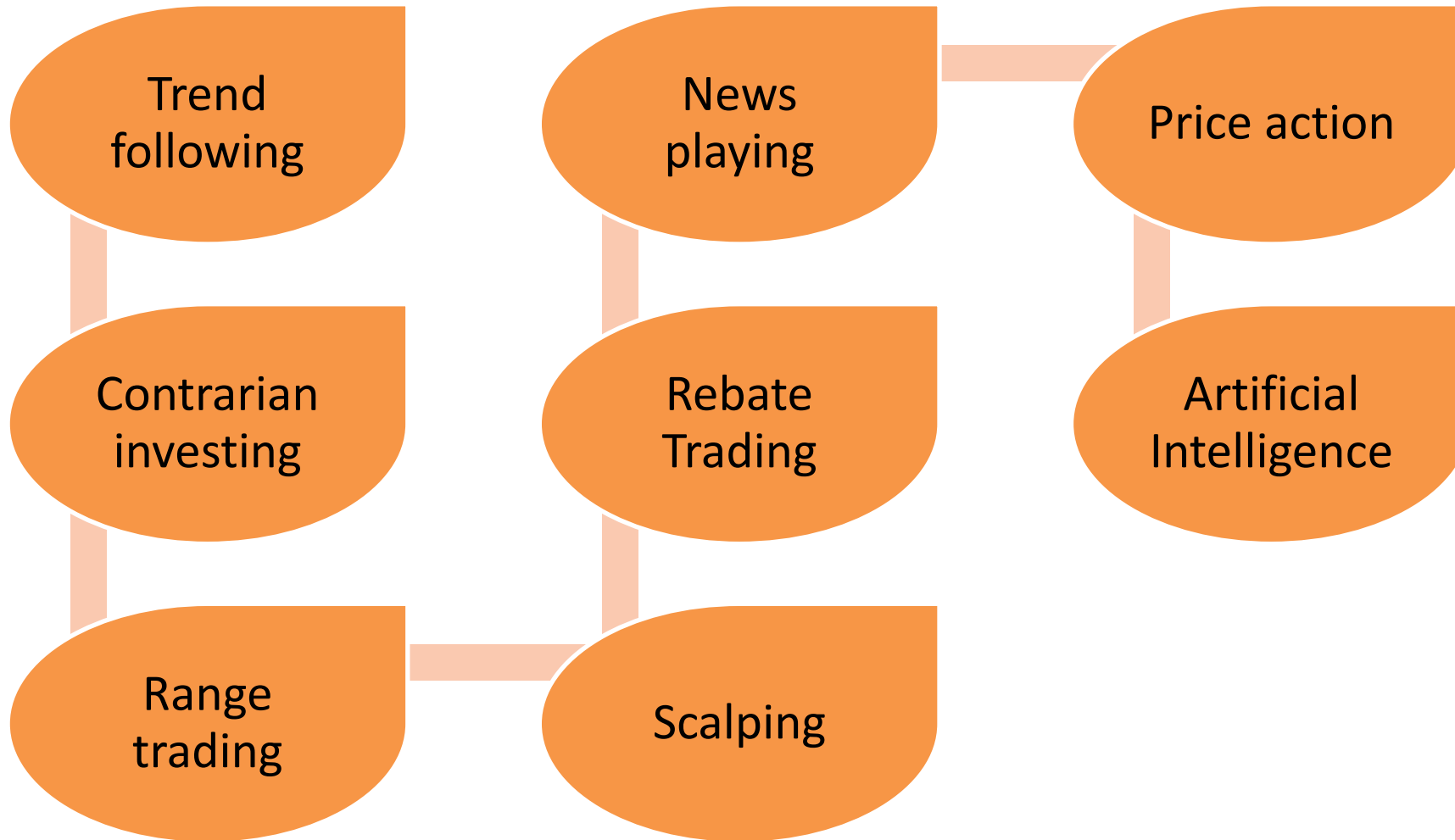
Improvements

- Stick to your guns
- Set stop losses & take profits
- Don't watch minute to minute
- Eliminate high probability trading
- Accept that full time day trading is rough
- Don't get attached
- Pick swing traders or day traders
- Talk to other traders.

Advantages of Day Trading

- No overnight risk
- Day traders can make profit in any direction
- Increased leverage more buying power
- High Returns
- Low brokerage commission
- You are in cash at the beginning & end of day
- Less Risky
- You can do more trade
- Better learning opportunities
- Don't have to do much study

Techniques



Risk associated with Day Trading

- Lack of Risk Management
- Lack of, or an improperly tested strategy
- Your Broker
- Your Technology
- Lack of order knowledge
- Yourself, your tendencies & your personality
- Final word on knowing just enough to be dangerous