

ShareScope

Alpesh's guide to using the Alpesh Patel Special Edition



Section 9

Trade Management

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Stick to these rules and you'll have a better chance of success.

Risk Management

Most investors and traders fail through lack of risk and money management. In order to open a trade you of course need to believe that the trade will be successful. But the reality is that many trades will not succeed. By understanding this, you should be able to take a more level-headed approach. Never risk more than a fraction of your capital on a trade or investment.

There is a very simple calculation you can do to determine the maximum amount you should trade per point on a spread bet.

First determine the maximum amount of money that you are willing to risk on a trade. I recommend 3% of your trading funds. If you have £1,000 in your trading account, then you should not lose more than £30 on any one trade. Now, you need to calculate where your stop loss will be set. Let's say that your stop loss is 20 points below your entry point. To calculate the size of your bet, divide £30 by 20 to get £1.50. Thus, if the trade goes bad and you get stopped out, the maximum you can lose is £30. (20 points x £1.50).

If you are just starting to trade and have a small amount in your trading account then your bet size and consequently your potential profits can seem very small.

DO NOT BE TEMPTED TO INCREASE YOUR BET SIZE.

By carefully managing your risk in the way I have described, your trading capital will gradually increase and you will in time be able to place larger bets.

Trade Management

Here is my 10 point plan for managing your trades.

1. Once you have identified a trading opportunity, decide upon your entry point. For me this will be if the price goes above the high of the previous day (it may take a day or two for this to occur).
2. Next, and before you open a position, determine a suitable stop loss. I generally pick a point below a recent support level (in the case of a bullish trade). Sometimes if that is not possible to discern I pick a level I call 2N - that is, twice the average daily range. So if the price, over the past couple of months, moves on average around 10p daily, then my stop loss would be 20p from entry. This approach will prevent you from being stopped out by normal daily volatility. Two times daily range would suggest a change in direction. ShareScope Plus and Pro users can use add the **Average True Range** indicator to graphs to see the average daily range over a specified period.
3. Now look at the number of points between your entry point and your stop loss. For example, if your entry point is 350p and your stop loss is 330p you have a 20 point difference. This is your RISK.

4. Make sure that there is potential for AT LEAST the same amount of profit from the trade. This is your risk/reward ratio and it must be at least 1:1. It is important that you are realistic about this. For example, the timeframe for Momentum/Value trades is 1-3 months. Extrapolate the trend over this time period and consider how low or high the MACD is. Alternatively, look for recent resistance levels that the price may retrace to. Don't convince yourself the profit potential is there if it isn't clear - move on to the next opportunity.
5. Once you are satisfied with the structure of your trade, calculate your bet size based on your risk and the money management rules above and open your position.
6. Whilst a trade is in play, we are looking for exit points. I get nervous if a 2 day low occurs – that is, the price moves lower than it has done on both of the previous two days. If it is a large price move, it may form more than a 2 day low (e.g. a 5 day low).
7. For Momentum/Value trades (1-3 months timeframe), I first check the weekly MACD. If it is still rising, I am happy to stay in the trade. If it is flat, I take half profits but stay in the trade. I'll close my position if a 3 day low occurs (i.e. the price goes below the 2 day low that triggered my caution).
8. For shorter-term divergence trades and my Bullish Momentum trades, I check the daily MACD. If it is flat or going down, I exit the trade. If the MACD is still going up, I'll take half profits and stay in the trade. I'll exit if a 3 day low occurs.
9. For Bearish Momentum trades, you'll be looking for a 2 day high and then a 3 day high and a flat or rising MACD.
10. If the overall market is very nervous, or if there is significant negative news for a stock I'm trading, then I'll exit on a 1 day low.

You can use these tactics with end-of-day or intraday charts. With intraday charts, you will be able to act upon 2 and 3 day lows as soon as they occur.