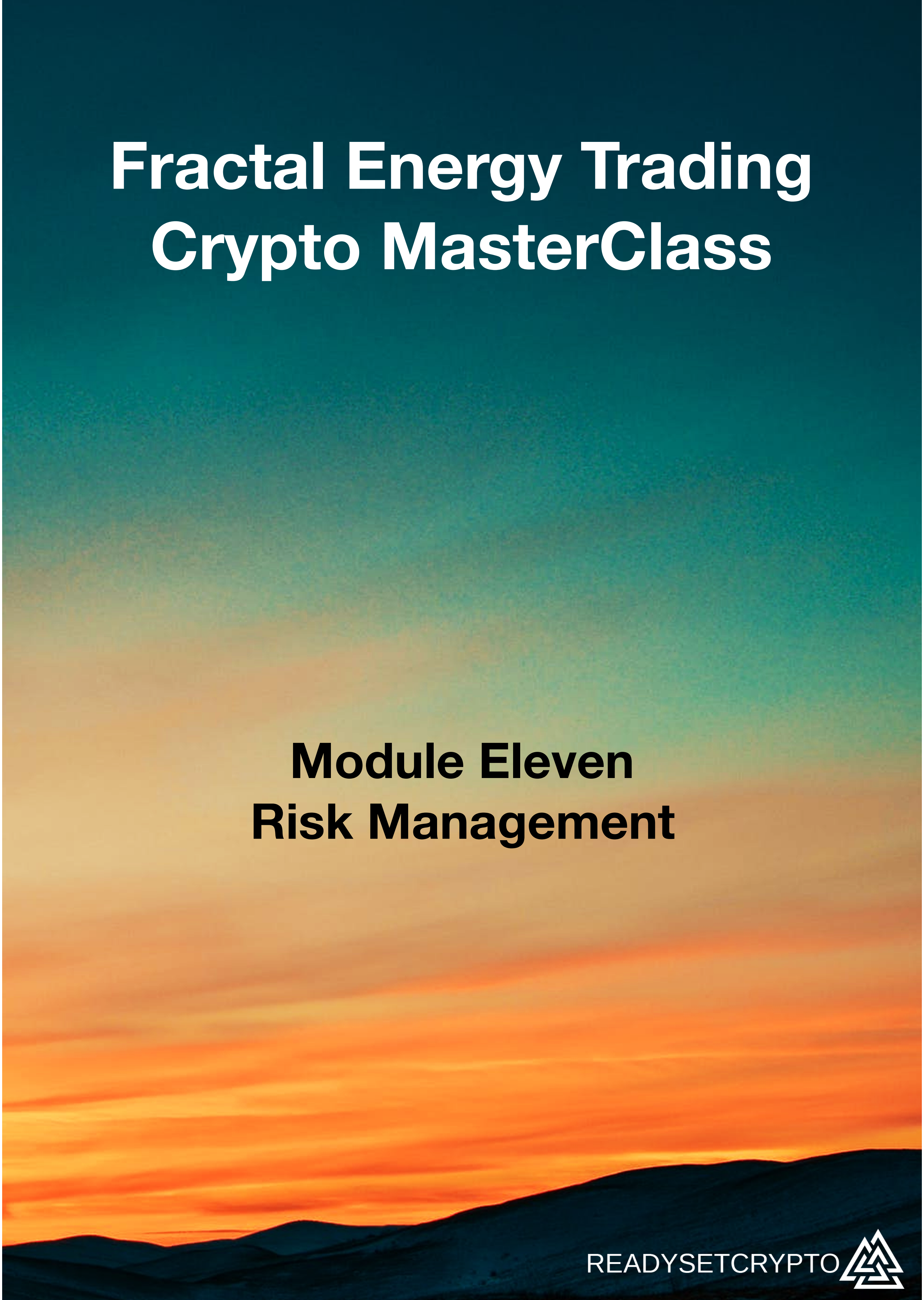

Fractal Energy Trading Crypto MasterClass

Module Eleven
Risk Management

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Introduction to Risk Management

Well, there's a compelling title, right? Bet you saw the outline of this course and COULD NOT WAIT to get to this material!

I'm kidding, of course. Most traders treat the topic of "Risk Management" with the same enthusiasm as a trip to the Dentist. But if there were just *one thing* that separates Retail traders from Professional traders, it would be Risk Management.

Professionals know that the fuel that drives their trades is Capital. The more capital that you have, the more options that you have to diversify, invest in different areas, etc. But if you're out of capital, or just plain capital-constrained, it's going to be very difficult for you to make headway. Perhaps you already know this first-hand, which means that this module should be even more important for you. This is why professionals are obsessive about managing risk, because capital is the blood that drives their business.

I've been mentoring traders for well over a decade, and there are two major issues that EVERY trader will face. It's wired into our DNA, and there is not one Retail investor that I've worked with that has NOT faced these two issues in some form. And like a great wall, you cannot expect consistent results nor expect to "go pro" until you solve these two issues. They are not what you'd expect, either.

Issue Number One: It's not even close, this is the most common issue that I see across the board. The conversation goes like this: "*Hi Doc, I entered into XYZ investment a couple of months ago, and it's pretty far underwater. Should I hold it or sell it out and book the loss?*" The way to solve this is with what I call "Rule Number One of Risk Management" which is defined on the next page.

Issue Number Two: This is the second-most frequent question that I get, which goes like this: "*I entered into ABC position and it's underwater and now I have no capital left. I am depressed and have decided to seek counseling*." The way to solve this one is with what I call "The Golden Rule of Risk Management" which we'll cover in a few pages.

Now the good news: Both of these issues are ridiculously easy to fix, as you'll see. Yet I know that you will fight me every step of the way implementing them, because it goes against everything that you've "learned" from the number-one source of investor education, Hollywood and TV Commercials. Yes, no kidding, most people come into live markets with a majority of their "skills" learned over the years through entertainment indoctrination. Let's get busy correcting that.

Rule Number One of Risk Management

I’m telling you, you’ll be surprised at how easy this one is to fix, yet it’s the number one problem by far. Here it is:

Rule Number One: Do not place a live position in the market without FIRST defining what your exits are.

I mean, how simple is that? But no one does it!

Think about how powerful this is….you are defining your exits BEFORE you own the asset, BEFORE you get a chance to get nervous and make panicky, emotional decisions.

And I want you to be precise about them as well. None of this, “well, if I see weakness in the price I’ll sell it.” Not good enough, those are not specific instructions.

Remember, all of us are flawed human beings. We become irrational when decisions come about that involve risk. We sell at the first sniff of profits, afraid that they will evaporate. We hold onto losers too long, convinced that somehow they will come to their senses and rally. (This is also known as Eating Like a Bird and Crapping Like an Elephant)

The best way to do this is to create these forward instructions when we are NOT irrational, such as BEFORE we own a position.

And if you want to know, YES you should also define your profitable exits on a position ahead of time as well. This exact technique will depend on whether you are investing, scalping, swing trading, etc. You should plan out each trade and then follow that plan going forward. Admit that you’re a flawed, irrational human and just follow the plan that the “smart guy” created before you owned the position, thus effectively ending your ability to be objective.

Now, some of you that are going to define your exits with “stops” or defined “stop losses” will need the second rule below.

Rule Number Two: The Golden Rule of Risk Management

Rule number two is quite simple as well, but once again few follow it.

Rule Number Two: Do not risk more than two percent of your account per trade entry.

I call this the "Golden Rule" as this creates the "Midas Touch" to most traders once they start to incorporate these rules. Here are some of the benefits:

- **Fear** - you no longer live and die with each tick or candle while holding the position.
- **Risk** - you will experience no more than a 2% haircut with a loser.
- **Diversify** - by placing smaller positions, you don't create a huge "target" in one monolithic position, giving you the ability to add several smaller positions to diversify your holdings.

As I mentioned earlier, those using a "stop loss" to manage your position's risk with Rule Number One will do so at a two-percent (or less) level, which I'll cover in the video.

The first objection to this rule that I get from people is "*TWO PERCENT?!!! How will I get Lambo with only a two percent position?!*" Well, I'm not saying that this one two-percent position is the only one that you can enter in your account. You can create multiple two-percent positions, however I would not lump them all in one spot.

(But seriously, if "when Lambo?" Is the extent of someone's vocabulary then they will be unable to follow this rule and preserve capital)

Now, two percent is a guideline. That means that you'll have to lose fifty trades in a row to go belly-up, unlikely to happen. In practice, I find that I often risk far less than two percent on many trades.

How should you go about setting the risk level? You can do this by calculating the stop loss level, but my favorite way is to use a Fixed-Risk trade entry, described on the next page.

The Fixed-Risk Trade Entry

I get lots of questions from those wondering how to enforce a “stop-loss” order against a current “long” position that you hold. I don’t really like doing this, for these reasons:

- A stop-loss order tends to get “picked off” if markets get thin. Price can traverse lower very quickly with a “stop hunt” move if the instrument is illiquid, or during certain times, such as when brokers advertise that they are down for maintenance. A perfectly good trade will get stopped out for your max defined loss, then rebound.
- You book your loss if you get stopped out.

I like to do things a slightly different way; I adopt the “Viking Funeral” approach.

You’ve seen representations of the old Norse funerals, where they place the deceased on a boat and turn it into a pyre, left to burn down and sink later. This is the analogy that I’d like you to think about when you place your next trade. Set your trade alight, push it off from shore, and let it go. If you “release” the trade to do what it will in the market, you’ll spend a lot less time stressing over it. And there’s one key way to do this…

Define your max two-percent loss as the position size.

That’s it. Don’t define the two-percent “stop loss” for the position, just determine what two percent would mean to your account, then create the position to be that size.

You’re done. You can hold the position indefinitely and wait for it to hit your profit target. You have defined your loss from day one for the trade, so you’ve pushed it off from shore and can relax since your risk is defined.

I’ll show an example about how to do this in the module video.

Market Fractals and Risk Management

Many folks look at huge rallies and start counting the gains from what they could have made during the run-up that they were not in. “If I got in *here* and ran it up to *there*, I would have made *this much*.”

But it doesn’t work that way.

The emotions that come out during a huge run to the upside in any market will completely swamp any ability that you have to rationally calculate an effective exit point.

But I want you to consider executing risk management in this manner: **lighten up.** Yes, lighten up your buy/hold position if you see an absolutely, infinity-slope parabolic uptrend that screams higher every day. Take some off the top. Lighten up the position and book some gains.

Your monthly and weekly charts will likely show exhaustion at this level, which means that the uptrend’s on fumes and has a high likelihood of nasty failure before long….people got a big shock when Bitcoin recently dropped from 20k down to 11k in four days.

Use those larger-timeframe “exhaustion” signals as a red flag, and then be prepared to trail a “stop” up behind a parabolic asset. It’s OK to sell into strength, although you might be disappointed at the time.

Just don’t let greed blind you to the other side of risk, which is NOT taking profits into a parabolic uptrend. Even if you intend to hold something for years, taking some profits off the top is never a bad idea to manage risk.

Summary - Risk Management

Risk Management separates professionals from all of the other “wanna-be’s” that are in trading. Anyone can enter a position, but it’s understanding how to manage your capital effectively for the long-haul which is what’s important.

We talked about Rule Number One of Risk Management, as well as Rule Number Two/ The Golden Rule. Just doing those two simple things alone will set you apart from 99% of the pack. It sounds hard to believe but it’s true..I see the “normal” reactions every day.

And specifically for Crypto, I love using the “fixed risk” trade entries for directional swing trades. I will also use fixed-size positions for the “buy/hold” portfolio trades as well, but always with an exit in mind before I enter.

Again, these are not intended to be difficult concepts, but it’s not *easy* to break the bad habits of the past.

Homework and Next Steps

Please complete the following tasks before moving to the next module:

- [ ] Watch the associated video for this module.
- [ ] Have you violated Risk Management rules One or Two in the past? How did it turn out for you?