

Money management is the cornerstone of Forex trading. The main task of any novice trader is not the deposit multiplication as most of the people think – let us keep this goal to experienced traders who are in the market for several years. The key task of the novice trader is at least to **survive** in the market or to **break even** in the long term at the best.

To understand what is more important, a profitable strategy or risk management, we should consider two stories of two typical traders.

|  |  |  |
| --- | --- | --- |
| Trader #1 |  | Trader #2 |
| Proven profitable strategy |  | Doesn’t have a clue about the strategy’s performance |
| Complete lack of money management rules |  | Insanely strict money management rules |

## The story of trader #1

is painfully familiar to many traders: a man finally founds a trading technique that brings a stable income. After so many months (years) of attempts and mistakes, the trader feels that he has understood the market and is able to subdue it. However, it should be noted that no matter how wonderful a strategy is, it anyway involves losing trades because it is impossible to win all the time. Let’s suppose that trader #1 wins in 70% of cases and opens 1 order every single trading day (about 20 trades per month and 6 of them will be unprofitable). Without any money management and without a 100% necessary rule to put a stop loss, the following can potentially happen:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Trade | Lot | Risk per 1 pip | Stop loss | Take profit | Pips | Profit / loss |
| #1 | 0.04 | $0.4 | 0 | 0 | +70 | $28 |
| #2 | 0.2 | $2 | 0 | 0 | +90 | $180 |
| #3 | 0.3 | $3 | 0 | 0 | -169 | $-500 |

In this example, lot is selected at random, simply because the trader "*is feeling*" that the profit is waiting ahead. And of course, if one feels that today will be a profitable day, then he can set a lot value of any amount (for example, setting a lot=3 with a deposit of $300). Two trades were quite profitable and after them the trader has $300 + $28 + $180 = $508. In trade #3, market moves 169 pips against the trader’s order and eliminates all previous successful orders.

Stop loss should never be put based on the "*I'm always right*" concept. Market never forgives such behavior. You can be lucky for some time, you can even double your deposit in a couple of days, but once you will stumble upon a strong countertrend which will destroy not only all your profit but also the entire initial deposit.



## The story of trader #2

is known to not so many traders as there are not many disciplined traders in Forex. This trader has set two money management rules that are 100% obligatory for implementation:

1. To risk with no more than **2%** of the deposit in 1 trade
2. To risk with no more than **6%** of the deposit in a month

## Examples

If our trader loses all the time (which is impossible at least because of the theory of chances), he will have to trade for 11 months to lose just a half of the initial deposit. 11 losing months in the context of our system are equal to 33 losing trades in a row. If you started with the sum of $500 and you lost a half about a year later, it is relatively a quite low fee for your Forex education ($500/2/11 = $22 per month).

One and a half year of losses (54 trades with a negative result), and you still have one-third of the capital; 3 years of continuous losses (3 \* 36 = 108 loss-making trades) – and you still retain 10% of the initial deposit.

If the only thing that happens to you in Forex is a loss, then two thoughts come to mind:

1. Either Forex is definitely not for you

2. Alternatively, you did not bother yourself to test your trading system on the historical data and therefore came to the market with a losing strategy.

## Conclusion

Extremely strict money management rules **do not guarantee** that you will earn in the Forex market, but these rules warrant that you will *stay on the market as long as possible* and lose a minimum amount of money.

In addition, *even the excellent strategy* will lead you to the loss of the whole deposit in case if you do not set stop losses.



## The risk calculation table

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| The number of the month | Deposit at the start of the month\* | 2% in a trade | Stop loss\* | $/pip | Divider\* | Lot | 6% in a month | Deposit at the end of the month | % from the initial deposit |
| 1 | 5000.0 | 100.0 | 50 | 2.0 | 10 | 0.20 | 300.0 | 4700.0 | 94.00% |
| 2 | 4700.0 | 94.0 | 50 | 1.9 | 10 | 0.19 | 282.0 | 4418.0 | 88.36% |
| 3 | 4418.0 | 88.4 | 50 | 1.8 | 10 | 0.18 | 265.1 | 4152.9 | 83.06% |
| 4 | 4152.9 | 83.1 | 50 | 1.7 | 10 | 0.17 | 249.2 | 3903.7 | 78.07% |
| 5 | 3903.7 | 78.1 | 50 | 1.6 | 10 | 0.16 | 234.2 | 3669.5 | 73.39% |
| 6 | 3669.5 | 73.4 | 50 | 1.5 | 10 | 0.15 | 220.2 | 3449.3 | 68.99% |
| 7 | 3449.3 | 69.0 | 50 | 1.4 | 10 | 0.14 | 207.0 | 3242.4 | 64.85% |
| 8 | 3242.4 | 64.8 | 50 | 1.3 | 10 | 0.13 | 194.5 | 3047.8 | 60.96% |
| 9 | 3047.8 | 61.0 | 50 | 1.2 | 10 | 0.12 | 182.9 | 2865.0 | 57.30% |
| 10 | 2865.0 | 57.3 | 50 | 1.1 | 10 | 0.11 | 171.9 | 2693.1 | 53.86% |
| 11 | 2693.1 | 53.9 | 50 | 1.1 | 10 | 0.11 | 161.6 | 2531.5 | 50.63% |
| 12 | 2531.5 | 50.6 | 50 | 1.0 | 10 | 0.10 | 151.9 | 2379.6 | 47.59% |
| 13 | 2379.6 | 47.6 | 50 | 1.0 | 10 | 0.10 | 142.8 | 2236.8 | 44.74% |
| 14 | 2236.8 | 44.7 | 50 | 0.9 | 10 | 0.09 | 134.2 | 2102.6 | 42.05% |
| 15 | 2102.6 | 42.1 | 50 | 0.8 | 10 | 0.08 | 126.2 | 1976.5 | 39.53% |
| 16 | 1976.5 | 39.5 | 50 | 0.8 | 10 | 0.08 | 118.6 | 1857.9 | 37.16% |
| 17 | 1857.9 | 37.2 | 50 | 0.7 | 10 | 0.07 | 111.5 | 1746.4 | 34.93% |
| 18 | 1746.4 | 34.9 | 50 | 0.7 | 10 | 0.07 | 104.8 | 1641.6 | 32.83% |
| 19 | 1641.6 | 32.8 | 50 | 0.7 | 10 | 0.07 | 98.5 | 1543.1 | 30.86% |
| 20 | 1543.1 | 30.9 | 50 | 0.6 | 10 | 0.06 | 92.6 | 1450.5 | 29.01% |
| 21 | 1450.5 | 29.0 | 50 | 0.6 | 10 | 0.06 | 87.0 | 1363.5 | 27.27% |
| 22 | 1363.5 | 27.3 | 50 | 0.5 | 10 | 0.05 | 81.8 | 1281.7 | 25.63% |
| 23 | 1281.7 | 25.6 | 50 | 0.5 | 10 | 0.05 | 76.9 | 1204.8 | 24.10% |
| 24 | 1204.8 | 24.1 | 50 | 0.5 | 10 | 0.05 | 72.3 | 1132.5 | 22.65% |
| 25 | 1132.5 | 22.7 | 50 | 0.5 | 10 | 0.05 | 68.0 | 1064.6 | 21.29% |
| 26 | 1064.6 | 21.3 | 50 | 0.4 | 10 | 0.04 | 63.9 | 1000.7 | 20.01% |
| 27 | 1000.7 | 20.0 | 50 | 0.4 | 10 | 0.04 | 60.0 | 940.6 | 18.81% |
| 28 | 940.6 | 18.8 | 50 | 0.4 | 10 | 0.04 | 56.4 | 884.2 | 17.68% |
| 29 | 884.2 | 17.7 | 50 | 0.4 | 10 | 0.04 | 53.1 | 831.1 | 16.62% |
| 30 | 831.1 | 16.6 | 50 | 0.3 | 10 | 0.03 | 49.9 | 781.3 | 15.63% |
| 31 | 781.3 | 15.6 | 50 | 0.3 | 10 | 0.03 | 46.9 | 734.4 | 14.69% |
| 32 | 734.4 | 14.7 | 50 | 0.3 | 10 | 0.03 | 44.1 | 690.3 | 13.81% |
| 33 | 690.3 | 13.8 | 50 | 0.3 | 10 | 0.03 | 41.4 | 648.9 | 12.98% |
| 34 | 648.9 | 13.0 | 50 | 0.3 | 10 | 0.03 | 38.9 | 610.0 | 12.20% |
| 35 | 610.0 | 12.2 | 50 | 0.2 | 10 | 0.02 | 36.6 | 573.4 | 11.47% |
| 36 | 573.4 | 11.5 | 50 | 0.2 | 10 | 0.02 | 34.4 | 539.0 | 10.78% |



\* Note that the asterisks in the table are set to the columns to which the traders enter the data on their own depending on:

* the size of the initial deposit;
* the fixed size of stop loss that is involved in the trading system;
* the "divider" of the trader’s broker.

You will find the attached Excel-spreadsheet that automatically calculates the size of your lot.

