

Dynamic Trader Daily Report

Comprehensive Analysis and Education For the Serious Trader and Investor

Published By
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Wednesday, March 08, 2000

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The analysis and trading strategies described in this report are for educational purposes only. The commentary in this report may or may not relate to a specific trade recommendation made in the Dynamic Trader Report. The weekday issues of the Dynamic Trader Report are prepared by Stephen Griffiths and are primarily for trading education purposes with alerts for potential trade set-ups for markets described in the Saturday issue prepared by Robert Miner.

Today I would like move onto a completely new topic, Initial Risk, which will lead onto thinking of Profits and Losses as a function of the initial risk rather than in straight dollar terms.

Initial Risk

Firstly the title of this section, initial risk, is actually incorrect as risk is the probability of an event occurring and has absolutely nothing to do with the initial dollar amount a Trader is willing to commit to a trade. This is the common term used in the industry, so I will stick with it.

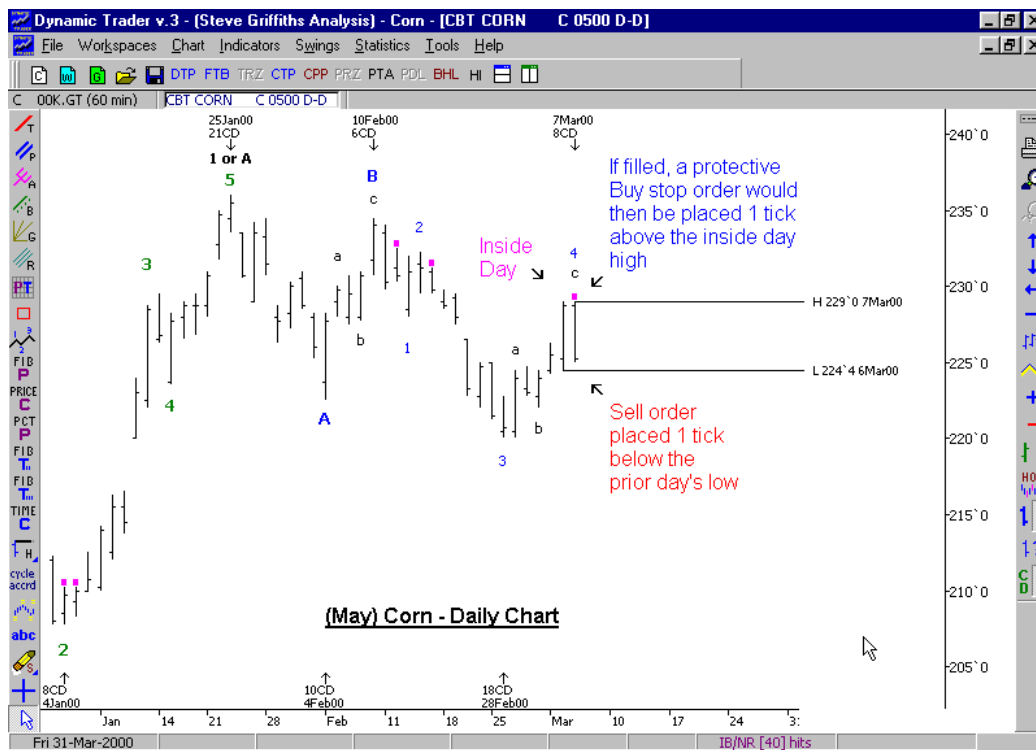
Although this title is technically incorrect, here is the definition of Initial Risk on a new trade I will be using during these training tutorials:

- **Initial Risk** = (opening price – initial protective stop price) x tick value

Which gives a dollar value to the amount the Trader would lose if the trade moved against them straight away.

A better term to use would be **Capital exposure**, as this is the amount of capital a Trader is willing to expose to the market to find out if his current opinion of the market is correct.

Let's have a look at an example:



Here I have taken the specific trading recommendation from yesterday's report where we are looking to sell the break from the inside day on Mar 7 in (May) Corn.

Where:

- Trade entry is 1 tick below the prior day's low at 224 ¼
- Initial protective stop is 1 tick above the inside day high at 229 ¼

Therefore the Initial Risk, or Capital exposure on this trade would be:

- **Initial Risk = $(224 \frac{1}{4} - 229 \frac{1}{4}) \times \$50 = \$250$**

This is for one contract and does not take account of commission charges or slippage.

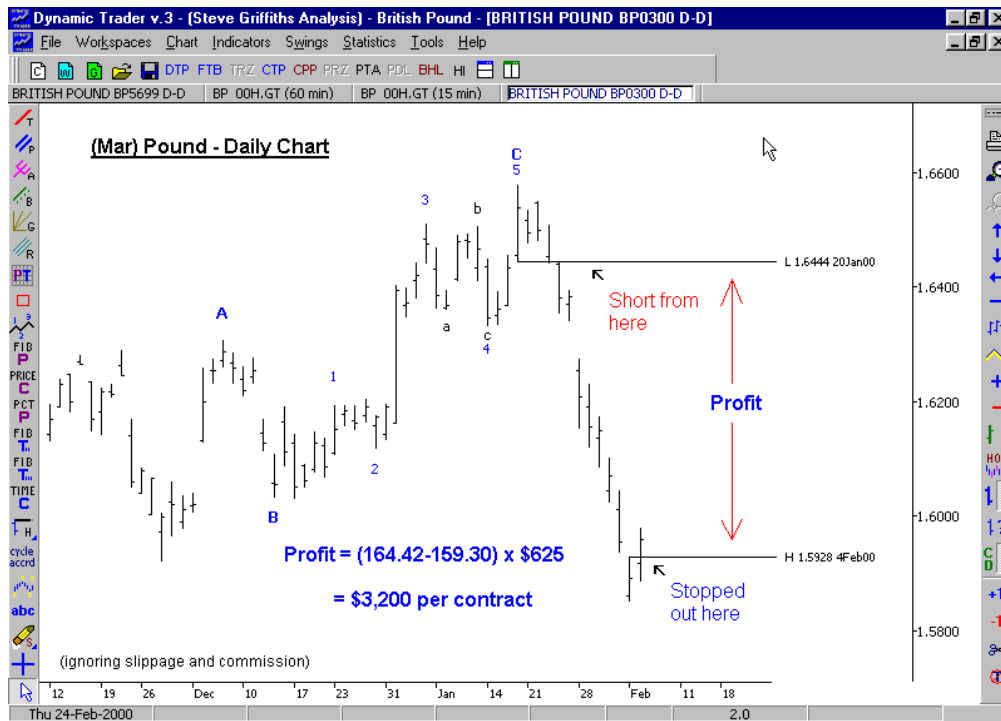
Let's have a look at another example, taken from a recent specific trade recommendation in the Pound. Please see the first chart on the next page

Next I would like to look at the Profit from this trade, not in pure dollar terms, but as a function of this initial risk. Please see the second chart on the next page.

Initial Risk



Profit



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Here we can see that the initial risk on this trade was \$687.50 per contract (ignoring slippage and commission), and the resulting profit was \$3,200 per contract (ignoring slippage and commission).

This profit of \$3,200 is very nice, but on its own it is meaningless, as we need to know how much the Trader had to risk in the first place to make this profit. In other words it is the relationship of the resulting profit to initial risk that is the important factor and not the pure dollar amount. This is called risk/reward.

Where the risk/reward is calculated as (Profit / initial risk), in this example we have:

$$\text{Risk / Reward} = (\$3,200 / \$687.50) = 4.65$$

In other words the profit was just over 4 ½ times greater than the initial risk or initial capital exposure. Or put another way, for every profit of this dollar amount you could make four consecutive losers with this same dollar initial risk and still make money!!

Please note that this calculation can only be performed as the profit on a trade increases. So many books, trading courses and software programs talk about only taking trades that have a better than 3/1 risk to reward ratio. This is meaningless, and demonstrates that the author or software designer has little or no practical trading experience.

Yes we can have an opinion on where the market will go using the *typical* Price targets for our current Elliott count, but that is all it is, an opinion. The only thing we can define is the potential initial risk or capital exposure on a trade by where the initial protective stop is placed. Even this is not a sure thing as a market can gap against you, beyond the stop price.

This is where the dynamic trading approach is so different from many other technical trading strategies available today, as we are able to project the high probability Price and Time areas where market trends are likely to terminate. Hence our trade entry strategies very often allow us to enter a trade on the very day of, or very close to, the actual trend change, enabling us to keep this initial risk so small in comparison to Profits. The same applies to all our trade entry strategies.

Remember, the overriding requirement for long term trading success is capital preservation, this means keeping losses small. The next objective, if the market moves in the anticipated direction, is to remain in the trade for the majority of the trend, this means maximizing Profits.

The Risk / Reward calculation gives us a method of quantifying this.

Tomorrow I will develop this theme further with a look at how to calculate the number of lots, or contracts you can trade depending on your account size. In other words, always taking a consistent initial risk or initial capital exposure as a percentage of your portfolio with each trade.

Today's Trading Lessons

1. Initial risk or initial capital exposure on a new trade can be defined as (opening price – initial protective stop price) x tick value
2. As a trade amasses profit, this profit should be thought of as a function of the initial risk, rather than in straight dollar terms. This is risk / reward.
3. Where the risk / reward is calculated as (profit / initial risk).

Continued on next page.

Potential Trade Set-ups and Trade Follow-ups

Yen (March) Today the Yen made a narrow range *inside day*.

Short and Intermediate Term Units (L-2/28, 91.87)

Maintain the protective sell-stop on both units 1 tick below the 1-day low, 93.35 for tomorrow.

Bonds (June) Today Bonds continued the move sideways with an *inside day*.

Stand aside from this market for now, the parameters that will signal the direction of the next minor trend are either a trade above 95-14 or a trade below 94-05, as outlined in Saturday's Report.

Corn (May) A new short trade was entered at 224.2 today. A close below 224 confirms that Mar 7 completed a minor abc correction off the Feb 28 low. 224 is the minor Wave 1 or A closing high of Feb 29.

Short and Intermediate Term Units (S-3/8, 224.2)

Maintain the protective buy-stop on both units at 229.2.

S&P (June) If Today's low completed a Wave 1 or A low, then the Wave 2 or B correction is anticipated to reach at least the 50% Price retracement at 1399.75.

Silver (May) Today was a *Gann Pullback* and an *Inside Day*. Although not a specific trading recommendation as I do not have a firm opinion of the short term position of Silver, Traders may consider a short trade on a break below Tuesdays low of 510.5 for a *trend continuation* trade.

Good Trading,

Steve

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