

# Dynamic Trader Daily Report

Comprehensive Analysis and Education For the Serious Trader and Investor

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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.

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Today I would like to look at how many contracts you should trade, depending on your account size.

## The Number of Contracts to Trade

Why is it important to have a consistent approach to deciding the number of contracts to trade on each new position? Surely, we should simply trade one lot for the short-term unit and one lot for the long-term unit?

The main reason for applying a consistent approach is to avoid overtrading. Overtrading is one (if not the main) killer for trading accounts. As we saw yesterday, the overriding requirement for long-term trading success is *capital preservation*. Losses are inevitable, in fact losses are an integral part of our Trading Plan, but it is keeping these losses to a minimum that enables us to have the required capital to be able take the profitable trades necessary to remain in business.

This is why I suggest you limit your maximum initial risk or initial capital exposure on any new position to a maximum of 5% of your trading account. I actually use 3% as a maximum myself, and many professional traders I know reduce this percentage still further.

Why are we so conservative with this initial risk or initial capital exposure? W.D. Gann recommended in his books that you should divide your trading capital into tenths, hence risking 10% on any one trade. This could mean that after 3-4 consecutive losses, nearly half your trading account would have disappeared. You would then have to make nearly 100% profit just to get you back to your original starting point!

Psychologically, this would destroy most traders (psychology of trading is a topic in its own right, and one I intend to cover in a future tutorial). So why put yourself at such a disadvantage for long-term trading success by simply trying to trade too many contracts too quickly?

Trading is all about probabilities, and stacking these probabilities on your side. Keeping your initial risk or capital exposure, and hence your losses, small is one of the best ways to keep the probabilities working for you.

Let's take a look at our two examples from yesterday on Corn and the British Pound for somebody trading with a \$25,000 account.

First, we need to work out what the dollar value of the 5% *maximum* risk on this \$25,000 account equates to:

- $\$25,000 \times 0.05 = \$1,250$ .

From yesterday:

- Initial risk per contract in the Corn example was \$250
- Initial risk per contract in the Pound example was \$687.50

Hence this trader could trade five Corn or two Pound contracts for the same 5% initial risk or initial capital exposure on his / her \$25,000 trading account.

I have actually written a small Excel spreadsheet to perform this calculation for me quickly and easily:

| Commodity             | Long or Short | No of Lots | Initial Price            | Stop Price       | Tick Value  | Profit / (Loss)               | % Risk             |
|-----------------------|---------------|------------|--------------------------|------------------|-------------|-------------------------------|--------------------|
| Current Portfolio:    |               | €15,822.78 | 1.58                     | \$25,000.00      | Commission: |                               | \$0.00             |
| Contract Long         | Long          | 1          | -<br>Current Price:      | -<br>-           | \$50.0      | #VALUE!<br>#VALUE!<br>#VALUE! | #VALUE!<br>#VALUE! |
| Contract Short        | Short         | 5          | 224.25<br>Current Price: | 229.25<br>224.25 | \$50.0      | (\$1,250.00)<br>\$0.00        | 5.00%<br>0.00%     |
| Profit to Loss ratio: |               |            |                          |                  |             | 0.00                          |                    |

Here we can see that for this \$25,000 account, 5 contracts of Corn on this particular trade equates to an initial risk or initial capital exposure of 5%.

This leads onto the question of what a Trader should do if the initial risk or initial capital exposure on a new trade is above the 5% maximum on the current size of his or her account?

The simple answer is to pass this particular trade by for another with an acceptable initial capital exposure. There will normally be a trend continuation set-up, or a new set-up in another market, where the capital exposure is within the limits of the trading plan.

The next question this raises is what to do when you have carefully performed all these calculations for the number of contracts to trade based on the position of the initial stop loss, but then the market gaps away on open, filling you at a worse price and hence increasing your initial risk?

Here you have several options, depending on the amount of access you have to market data during trading hours:

1. You could wait until the market opens before placing your entry order, thus making sure you avoid any unwanted gaps.
2. If you were filled at a worse price than your initial order, you could close the number of contracts to bring your initial risk back under the 5% maximum.
3. Place a limit order with your broker, specifying that you do not want the order to be filled at price worse than your limit price.

These options would mean that sometimes you either end up with less contracts on a profitable trade than you originally wanted, or even missing a profitable trade altogether. This is far better than taking a larger than necessary loss.

So many trading courses, books and newsletters only focus on the Profits, whereas if they had practical trading experience in the markets they would appreciate that the overriding requirement for long-term trading success is *capital preservation*, which means keeping trading losses to a minimum.

This is born out in interviews with some of today's top traders in the "Market Wizards" books. Although these traders have many different approaches to analysis, one of the factors they all share is their attitude to minimizing losses.

## Today's Trading Lessons

1. Keep the Initial Risk or initial capital exposure on any new trade below a maximum of 5% of your trading account.
2. This 5% figure is for you to decide in your own trading plan, I personally use a figure of 3%, and many professional traders I know use a value lower than this.

**Continued on next page.**

## Potential Trade Set-ups and Trade Follow-ups

### **Yen (March)**

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, 93.74 for tomorrow.

**Corn (May)** Today's high stopped out the current short trade. Corn has still not shown signs that the rally off the Feb 28 low is the start of a new impulsive trend. As yesterday, a close below 224 confirms that the current minor rally is only a correction off the Feb 28 low. 224 is the minor Wave 1 or A closing high of Feb 29.

Short and Intermediate Term Units

Flat.

**Bonds (June)** Every recent minor high and low has been at or very near a 78.6% retracement. Today's high is also at the 100% Alternate Price Projection and the 78.6% retracement.

There has also been a consistent 9-11 bars high-to-high rhythm; today's high is at 10 bars. The recent rallies have also unfolded as three wave structures, this is more indicative of a correction.

Although not a specific trading recommendation, Traders may want to consider a short position below the last B wave low of 94.17 - see the first chart on the next page.

**S&P (June)** Today the S&P rallied as anticipated. A close above the 78.6% retracement at 1418.48 confirms that yesterday completed a Wave 2 or B low. The S&P should now continue to rally to above the Mar 3 high of 1432.50.

The next resistance area is 1450 – 1452.50

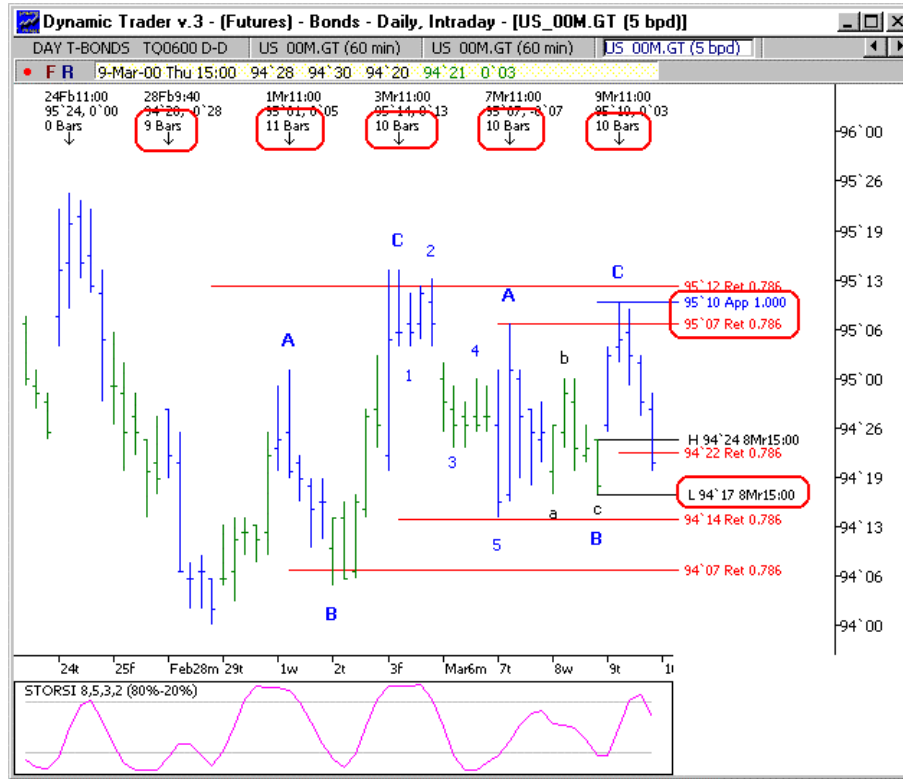
This includes the *typical* Price target for a Wave C and the 61.8% retracement of the Jan 3 to Feb 28 decline. See the second chart on the next page.

Good Trading,

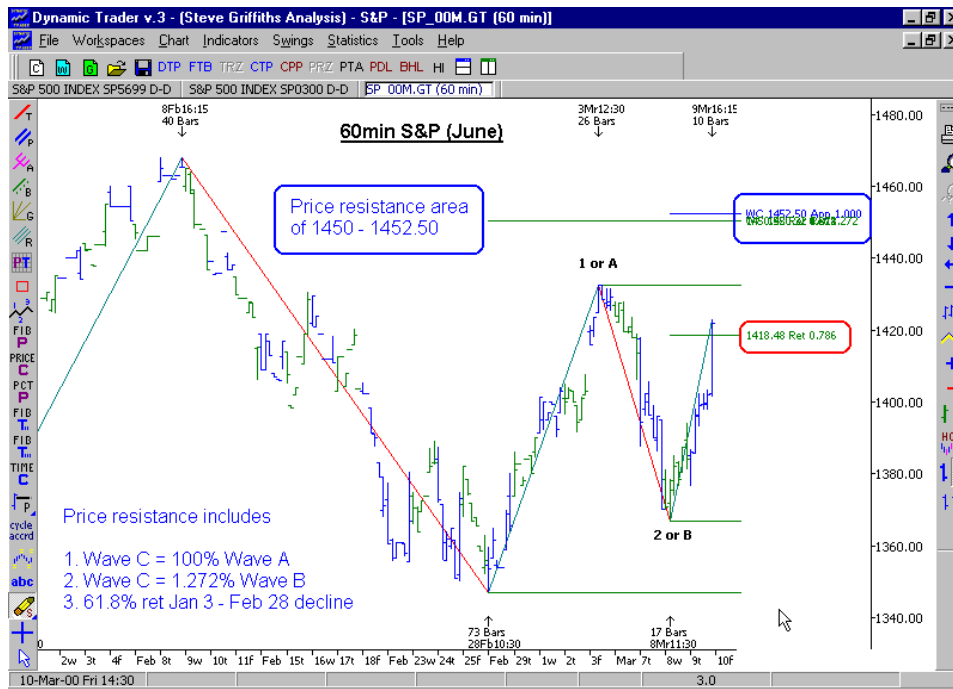
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### Bonds Chart



### S&P Chart



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