

Dynamic Trader Daily Report

Comprehensive Analysis and Education For the Serious Trader and Investor

Published By
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Tuesday, May 16, 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's Lesson

How to calculate initial capital exposure as a percentage of your trading account.

Yesterday I covered how to calculate initial capital exposure and suggested that if the initial capital exposure of a new trade was too high it would be wise to pass the trade by for another opportunity at a future date. Today I would like to take this one step further and define exactly what is "too high".

W.D. Gann suggested splitting your trading capital into 1/10's and never risking more than one tenth on any new trade. If a trader took 34 consecutive losses it would result in wiping out nearly half of their trading account. This would be difficult to recover from, as now the trader would have to make almost 100% just to get back to their original starting capital. This is not counting the emotional and physiological trauma a loss like this would cause.

You would be surprised at the number of traders that do not or are unwilling to control the potential downside of their trading which results in far too many trades being taken that result in losses that are excessive for the current size of account.

The first thing I do before taking a new trade is to calculate where the initial protective stop loss will go. I then work out the initial capital exposure on the trade, based on the current entry price. If the initial capital exposure is too large for my account, then **NO TRADE** is taken, no matter how good the set-up looks!!

I cannot stress this enough, as the single biggest killer of trading accounts (especially smaller accounts) is large losses. Keeping large losses out of your account will lay the foundation upon which long-term speculative success can be built.

What do I mean by a large loss?

I suggest that the initial capital exposure on any new trade should be limited to 3% - 5% of the current trading account. As an absolute maximum, this figure should not exceed 5%, but I recommend nearer 3%. I know many professional traders who use a figure less than this.

Let's take for example, a trader with a \$10,000 trading account and a 5% maximum initial capital exposure. Therefore this trader can only commit \$500 to any new trade: $\$10,000 \times 5\% = \500 .

In the two examples on Cotton from yesterday's report, this trader could *not* take the first trade as it carried an initial capital exposure of just over \$1,000 per contract and could only trade one contract on the second, inside day set-up, requiring a \$400 initial capital exposure.

$\$10,000 \times 5\% = \500 per new trade set-up

1. Number of contracts on set-up 1 = $\$500 / \$1,000 = 0$
2. Number of contracts on set-up 2 = $\$500 / \$400 = 1$

Whereas a trader with a \$50,000 trading account could take two contracts on the first trade requiring a \$1,000 initial capital exposure per contract and six contracts on the second, inside day set-up, requiring a \$400 initial capital exposure per contract.

$\$50,000 \times 5\% = \$2,500$ per new trade set-up

1. Number of contracts on set-up 1 = $\$2,500 / \$1,000 = 2$
2. Number of contracts on set-up 2 = $\$2,500 / \$400 = 6$

The exact figure each trader decides to use is a personal choice, but I cannot stress enough that 5% should be an absolute maximum. Most professional traders will use a value less than this. Some CTA's I know are only allowed by their companies to use a figure of 1% or less.

This may seem like a lot of unnecessary work, so to help me I have written a very simple excel spreadsheet program to perform these calculation for me. Please see the screen shot on the next page. This is very easy to do, and I suggest it is something you should all consider for use in your own trading.

All Contracts - Initial Risk Analysis

Current Portfolio:			\$50,000.00	Commission:		\$0.00	
Commodity	Long or Short	No of Lots	Initial Price	Stop Price	Tick Value	Profit / (Loss)	% Risk
Contract Long	Long	6	59.05	58.25	\$500.0	(\$2,400.00)	4.80%
			Current Price:			0.00	0.00%
			Profit to Loss ratio:				
Contract Short	Short	1				\$0.00	0.00%
			Current Price:			\$0.00	0.00%
			Profit to Loss ratio:			#DIV/0!	

In the second *inside day* set-up on Cotton, a \$50,000 account with an initial capital exposure of less than 5% can be traded with six contracts.

In the report we trade two units, one short term (ST) and one intermediate term (IT). This leads onto the obvious question, what to do if a trader can only take one contract, which one should be traded, the ST or the IT? This is a question only the trader themselves can answer; as they have to decide what time frame they wish to mainly focus on.

Tomorrow I will take this one stage further and suggest a method of tracking your open profitable trades as a function of this initial capital exposure, rather than in pure Dollar terms.

Lessons Learned

How to calculate initial capital exposure as a percentage of your trading account, and therefore how many contracts may be traded on each new trade set-up.

Good Trading,
Steve
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Specific Trade Recommendations Summary For May 16

This table only includes those markets with outstanding trades and new specific trade recommendations.

Market	New Trade Recommendations or Stop-Loss For Existing Positions
S&P: June <u>New Rec.</u>	<p>All analysis and trade strategies for the full S&P contract. Trade execution on the E-Mini contract.</p> <p>Today's rally stopped right in the Price and Time resistance areas outlined yesterday for a potential Wave C high. See chart below.</p> <p><u>ST & IT units:</u> As long as the S&P has not closed above 1480.5, sell on the close if the close is below the current day's open and the prior day's close (Reversal Confirmation Day). Place the initial protective buy-stop one tick above the recent swing high.</p>
Copper: July	<p>Today's rally stopped out the current short position at 84.95.</p>
Cotton: July <u>L-5/1, 57.19</u> Beans: July <u>New Rec.</u>	<p><u>IT Unit:</u> Trail the protective sell-stop one tick below the 1DL, 62.20 for tomorrow.</p> <p>Today Beans made an inside day, therefore providing another opportunity to enter a long trade. See chart below.</p> <p><u>ST & IT units:</u> As long as Beans do not close below 542.2 or trade below 537. Buy on a 555.2 stop. Place the initial protective sell -stop at 541.6.</p>
Coffee: July <u>New Rec.</u>	<p>Coffee appears to have completed a Wave 5:5 low with today's Outside Reversal Day. Although Coffee is not a market normally followed in this report, this does appear to be an ideal set-up. See the two charts below.</p> <p><u>ST & IT units:</u> Buy on a 95.80 stop. Place the initial protective sell-stop at 92.95</p>

Summary of Open Trade Positions As of May 16

Market	L / S	Unit	Opened	Price	Closed	Price	# Ctr	P/L	O/C
S&P: June	Short	IT	5/9	1419.25	5/15	1440	1	(\$1,037.5)	C
Cotton (July)	Long	IT	5/1	57.19	-	62.50	1	\$2655	O
Beans (July)	Long	ST&IT	5/10	564.0	5/15	555	2	(\$900)	C
Copper (July)	Short	ST&IT	5/15	84.05	5/16	84.95	2	(\$450)	C

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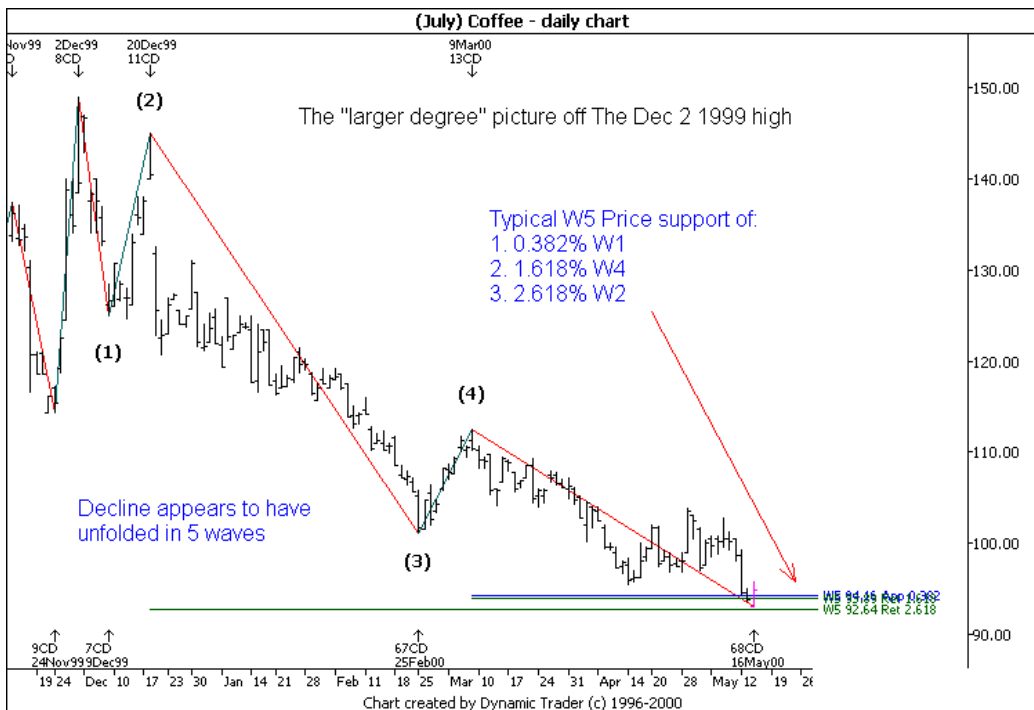
Other Markets of Interest Summary For May 16

Market	Other Markets of Interest
Nasdaq 100: June	Today the Nasdaq closed above the minor W1 closing low of May 3 at 3585. Although this voids the current short-term bearish count, the Nasdaq is in a similar position to the S&P, where today probably completed a corrective ABC rally off the May 10 low. This would be confirmed by a close below 3330, the minor Wave B low of May 15, or invalidated by a close above 3768, the 78.6% price retracement
Bonds: June	Should decline to below the May 8 low to complete Wave-5. Today Bonds appear to be in the process of completing an ABC Wave 4 high. See chart below for addition analysis and comments.
Dollar Index	Wave-5 top should be complete. A correction lasting at least four weeks and reaching 104.32 or lower should follow.
Corn: July	Similar position to Beans, today Corn made an inside day.

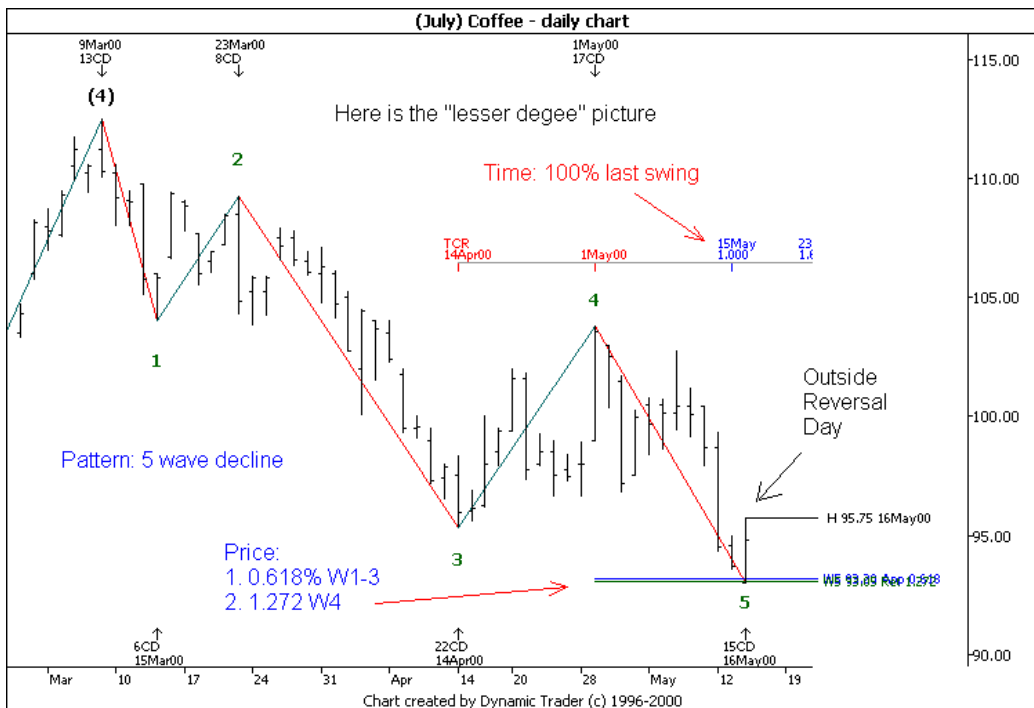
(June) S&P – 60min chart



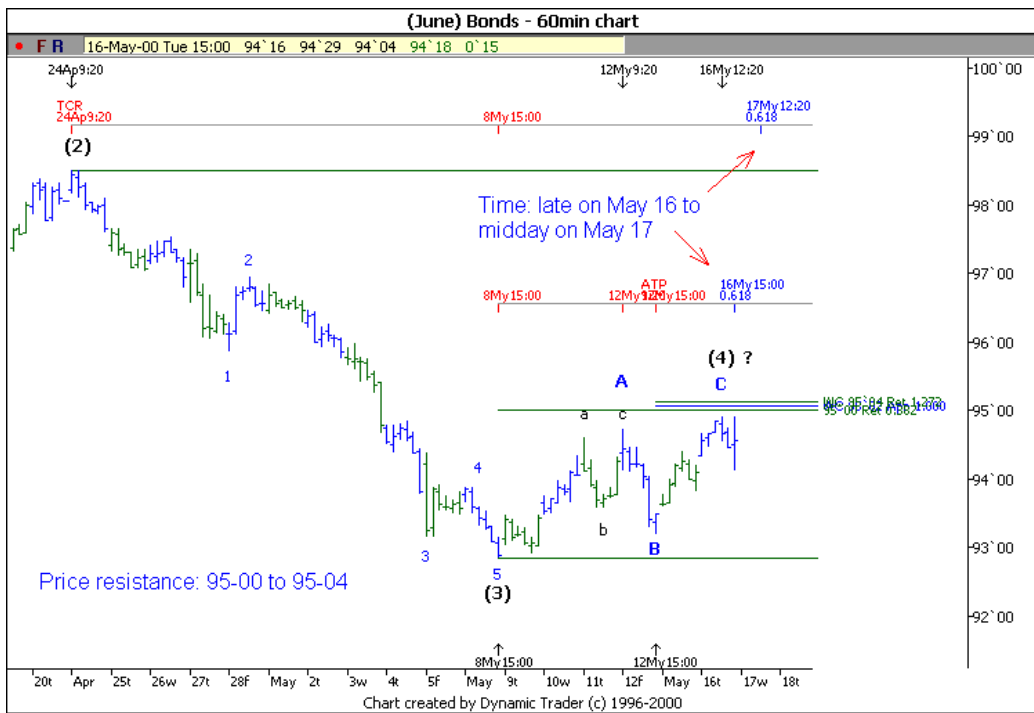
(July) Coffee – long-term daily chart



(July) Coffee – short-term daily chart



(June) Bonds – 60min chart



(July) Soybeans – daily chart

