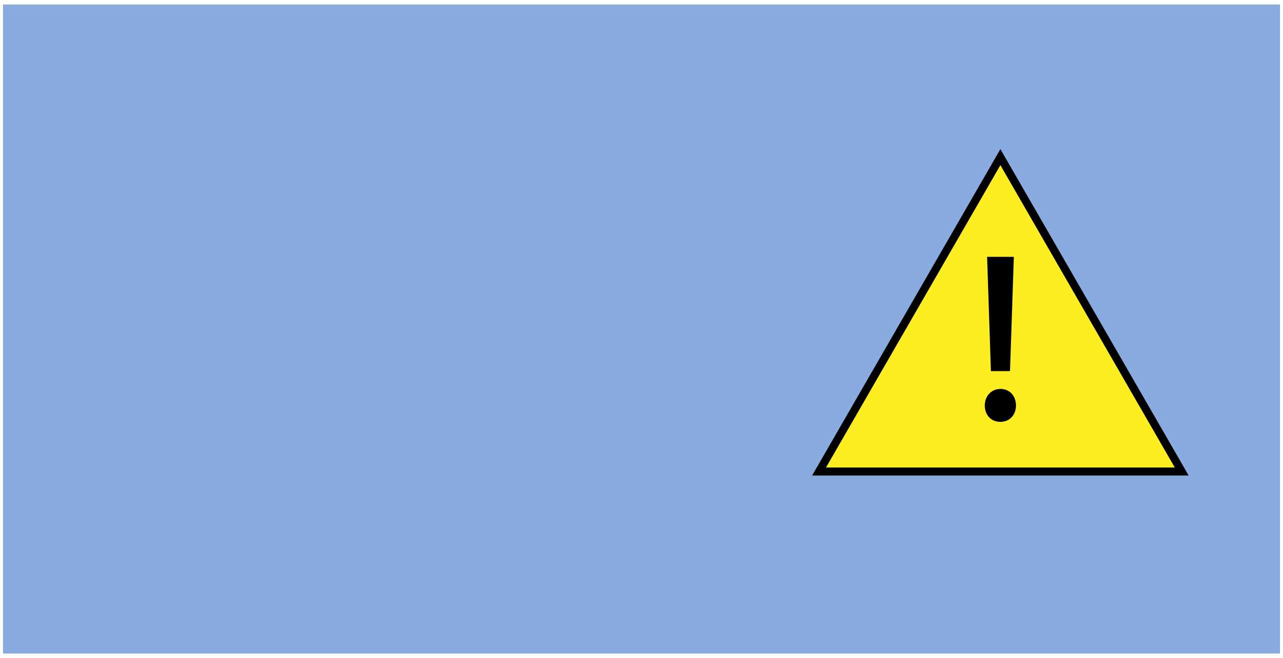
How to manage risk in Forex

More Than Trading

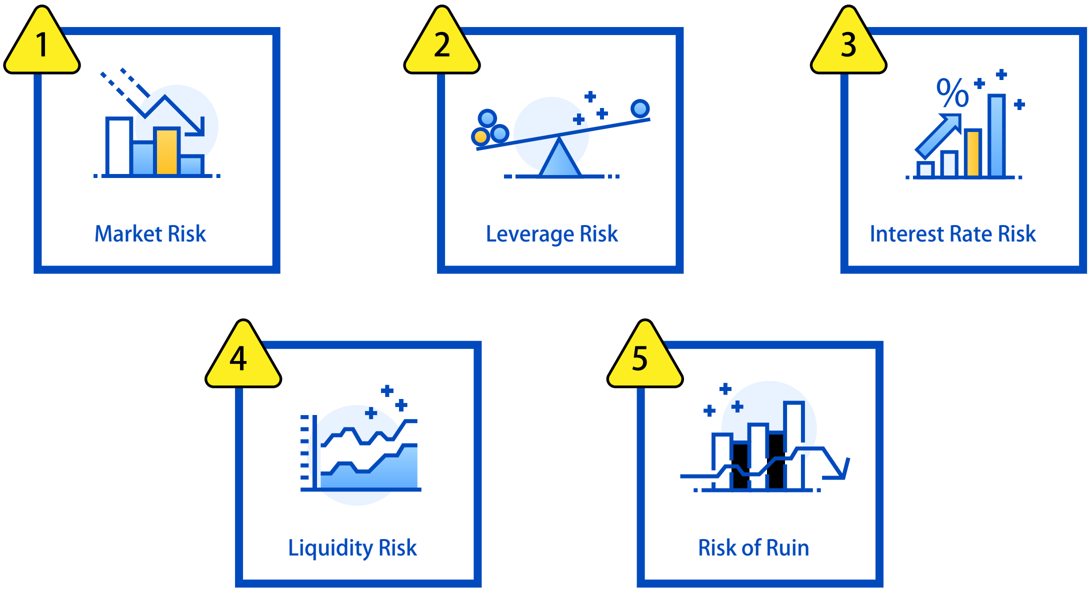
FOREX RISK MANAGEMENT



Forex risk management is one of the most, if not the most, important topics when it comes to trading. Many Forex traders experience profit loss in market trades but this is not due to inexperience or a lack of knowledge. Instead, poor risk management is the main reason why many Forex trades fail to achieve maximal profit. With the Forex Risk Management Strategy, potential losses can be minimised with each market trade.

The Forex market is one of the biggest financial markets. With more than $5.1 trillion USD transactions occurring each day, there is potential for banks, financial establishments and individual traders to successfully obtain huge profits but there is also the possibility to experience huge losses if known risks are not evaluated.

The Forex trading risk is the risk of loss that may occur when trading and these may include market risk, leverage risk, interest rate risk, liquidity risk and risk of ruin.



MARKET RISK

This is the risk of the financial market performing differently to how you expect and is the most common risk in Forex trading. For example, if you believe the US dollar will increase against the Euro and you, therefore, decide to buy the EURUSD currency pair, only for it to fall, you will lose money (This example is not good, better remove).

LEVERAGE RISK

It is common to see Forex traders invest in trades with a sum greater than the deposit available in their trading account since leverage is offered within the market. This can be risky as in some cases there is greater profit loss when leverage is used.

INTEREST RATE RISK

The interest rate can have an impact on the value of a currency exchange rate. (Please refer more info from wiki, this sentence is not clear enough)

LIQUIDITY RISK

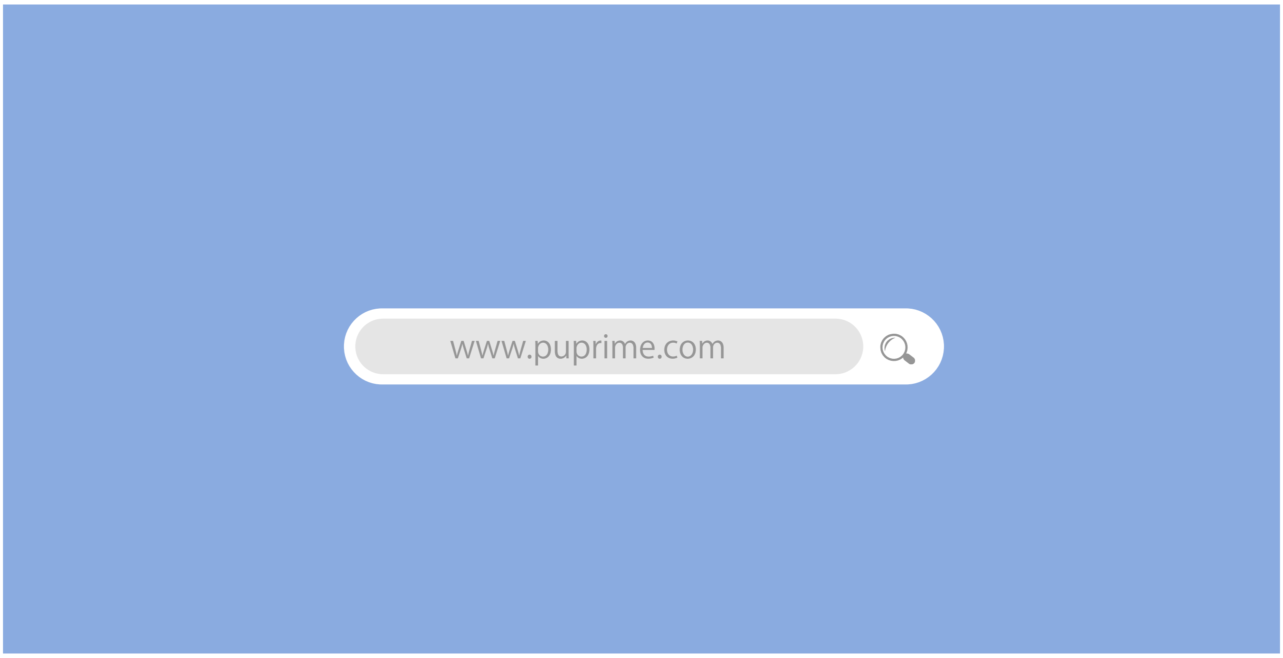
Some currencies are more liquid than others. If a currency pair has a high liquidity, this means that there is more supply and demand for them and, therefore, trades can be executed very quickly. For currencies where there is less demand, there might be a delay between you opening or closing a trade in your trading platform and that trade actually being executed. This could mean that the trade is not executed at the expected price, and you make a smaller profit, or even a loss, as a result.

RISK OF RUIN

This is the risk of you running out of capital to execute trades. Just imagine that you have a long-term strategy for how you think a currency's value will change, but it moves in the opposite direction. You need enough capital on your account to withstand that move until the currency moves in the direction you want. If you don't have enough capital, your trade could be closed out automatically and you lose everything you've invested in that trade, even if the currency later moves in the direction you expected.

You should now be fully aware that there are a number of risks that come with Forex trading! For this reason, as you will no doubt appreciate, the topic of managing your risk when trading Forex is very important. That is why we have put together a list of our top ten tips to help you do this effectively!

FOREX RISK MANAGEMENT



07 TIPS

Seven Tips for Forex Risk Management

Here are our top Forex risk management tips, which will help you reduce your risk regardless of whether you are a new trader or a professional:

Educate Yourself About the odds

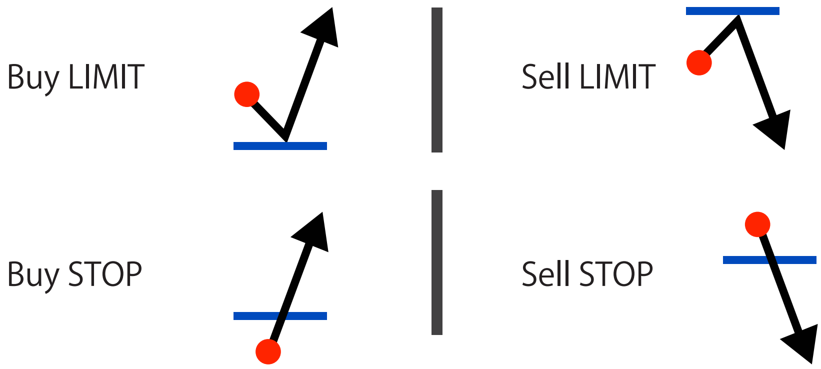
TIP 01

The first rule in risk management is to calculate the odds of your trade being successful. To do that, you need to grasp both fundamental and technical analysis. You will need to understand the dynamics of the market in which you are trading and the trigger points of the psychological price. Triggers points can be determined from a price chart.

If you decide to take part in a market trade, then you need to consider how to control and manage the risk. Remember that if you can measure the risk, it is likely you can manage the risk.

It is important to determine your safety threshold and know when to opt out when the risk of that market trade is not suitable. The difference between this cut-out point and where you enter the market is your risk. Can be removed?

Knowing about stop orders, limit orders and market orders will be highly beneficial. Explain these three different terms here.



TIP
02

Use a Stop Loss

The tool ‘Stop Loss’ allows the trader to set a predefined price where your trade will automatically close if there are unexpected market movements. If you enter the market assuming your asset will increase in value but instead it decreases pass your stop loss price, the trade will automatically close.

However, slippage [check if this is the right term?] occurs when the market behaves in an unpredictable manner. If price gaps are present, then your predefined safety threshold might be missed and your trade won’t automatically close.
It is recommended that you set your predefined price at no more than 2% your current balance and the loss margin should not be increased.

There are different types of stops in Forex. How you place your stop loss will depend on your Knowledge and experience. Common types of stops include:

- Equity stop
- Chart stop (technical analysis)
- Volatility stop
- Margin stop

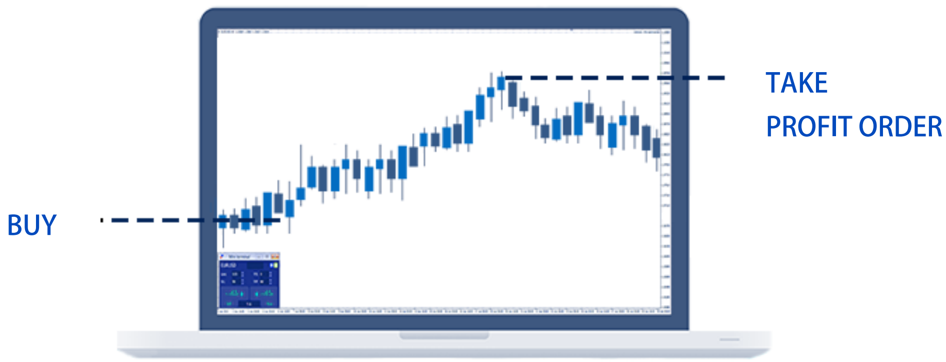
If you are consistently losing profit even with a predefined stop loss, you need to re-evaluate all your stops and determine which ones brought the best results. Simply adjusting your predefined price levels might lead to better trading results.
When profit is continuously increasing over time, your trading position might be set at $500 and your floating profit may be $500. In this instance, a protective stop may be used where you can lock in profits before the market makes an unexpected turn and move your ‘Stop Loss’ closer to your trading position at $500. Trailing stops can be used to…

Use a Take Profit to Secure Your Profits

TIP 03

Another tool 'Take Profit' is designed to close trades once a certain profit level is met. This is in contrast to the 'Stop Loss' tool where the trade is automatically closed to prevent further losses.

After setting a profit target and a take profit, you need to decide on an appropriate level of risk before engaging in any trades. Most traders aim for a 2:1 reward-to-risk ratio and only take on a trade when the expected reward is twice the risk.



Therefore, if you set your take profit at 40 pips above your entry price, your stop loss would be set 20 pips below the entry price (i.e. half the distance).

In short, think about what levels you are aiming for on the upside, and what level of loss is sensible to withstand on the downside. Doing so will help you to maintain your discipline in the heat of the trade. It will also encourage you to think in terms of risk versus reward.

Do Not Risk More Than You Can Afford to Lose

TIP 04

The Forex market is highly unpredictable and a common mistake new market traders often make is taking more risk than they are afford.

If all the losses leave you with no trading capital, then you are taking on too much risk.

Gaining back losses from Forex capital is difficult, especially when your trading account is in debt. For example, for a trading account of $5000 and $1000 is lost, then the percentage loss is 20%. To cover that loss, a profit of 25% from the remaining capital in the trading account is required. You should always calculate risk prior to engaging in Forex trading. If the chance of gaining profit is lower than the profit you are able to gain, it is recommended that you stop engaging in that market.

A recommended rule is to not risk more than 2% of your account balance per trade. I’ m not sure about the volatile part?

Be careful when you decide to re-gain your investment after a great profit loss. Investing in another trade when your account balance is already low is not recommended. Take time to identify a suitable high-probability trade where there is low risk and potential profit gain available before investing.

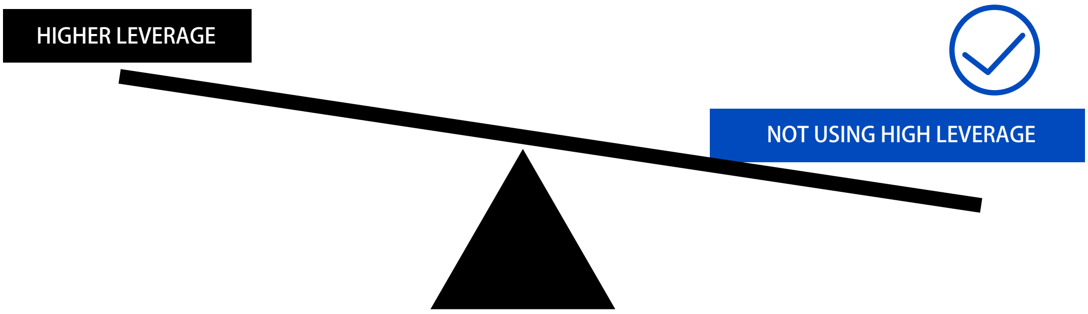
TIP 05

Limit Your Use of Leverage

Leverage involves using borrowed capital rather than your own capital. The spot forex market is a very leveraged market where a deposit of $1000 could result in $100,000 being trade and this is a 100:1 leverage factor. Leverge gives traders the opportunity to magnify their profits made from investment using their trading account. However, there are also disadvantages where losses can be exponentially increased, thus increasing the potential for risk.

If the market moves predictably in your favour, you will experience the full benefit of a $30,000 trade even if only $1000 was invested from your trading account. However, once the market moves unpredictably and against your favour, great losses will occur.

Your exposure to the Forex risk increases when there is higher leverage. For beginner Forex traders, a more sensible approach would be limiting exposure to high leverage. Only engage in high leverage markets once you have gained a clearer understanding of the potential losses associated with your particular trade.



Have a Forex Trading Plan

TIP
06

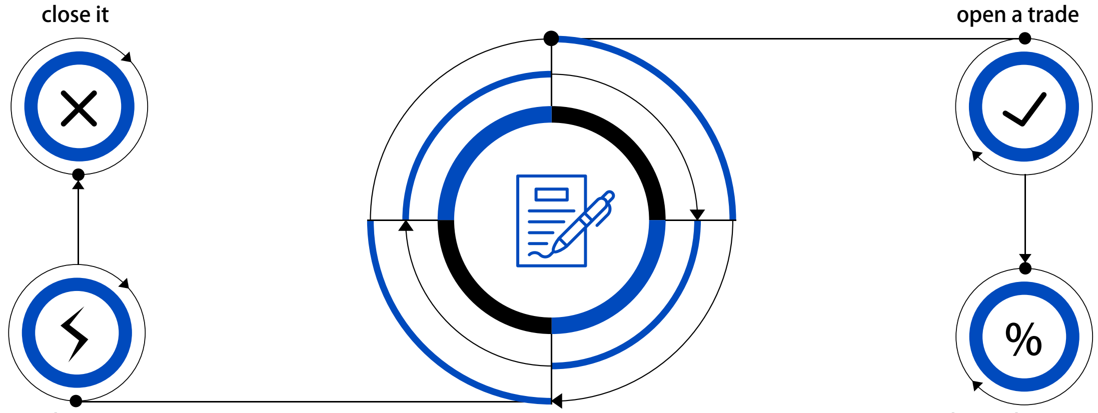
Having a plan prior to engaging in the trading platform is highly importance. Whilst some may base their profit increase based on luck, it is not the best approach.

To properly manage your Forex risk, you need a trading plan that outlines at least the following:

- When you will open a trade
- When you will close it
- Your minimum reward-to-risk ratio
- The percentage of your account you are willing to risk per trade

Stick to your trading plan as you know you have evaluated the risk and this will help minimise any potential losses that may occur through the engagement of the market trade. stick to your defined exist strategies as you don' t want to overtrade and this is essential for good risk management.

Your long term market performance will not be affected by a failed market trade. Remember not to change the rules of your risk management plan in hope that the current market trade will change from failing to succeeding.



Control Your Emotions

TIP 07

It is essential for Forex traders to be able to control their emotions. If you cannot control your emotions whilst trading, you will not be able to reach a position where you can achieve the profits you want from trading.

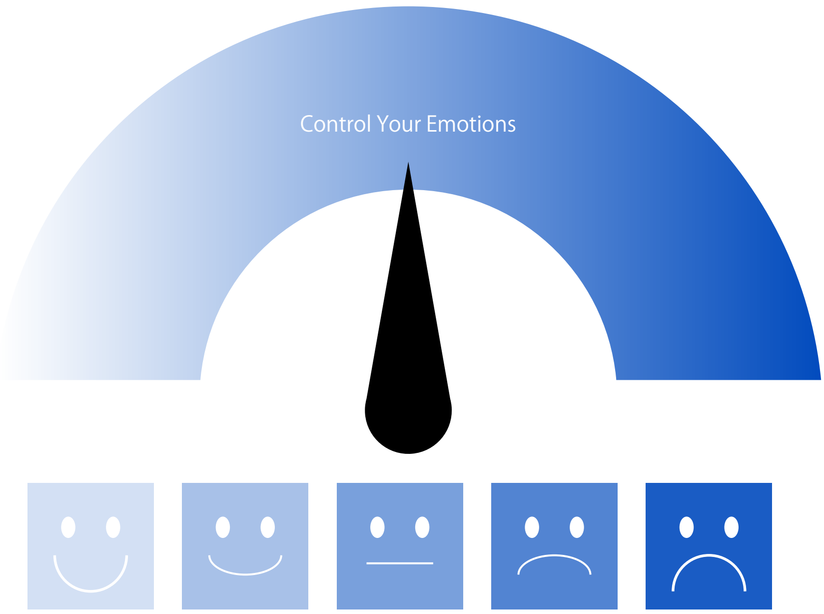
Why?

Emotional traders struggle to stick to trading rules and strategies. Traders who are overly stubborn may not exit losing trades quickly enough, because they expect the market to turn in their favour.

When a trader realises their mistake, they need to leave the market, taking the smallest loss as possible. Waiting too long may cause the trader to end up losing substantial capital. Once out, traders need to be patient and re-enter the market when a genuine opportunity presents itself.

Traders who are emotional following a loss also might make larger trades trying to recoup their losses, but consequently increase their risk. The opposite can happen when a trader has a winning streak - they might get cocky and stop following proper Forex risk management rules.

Ultimately, do not become stressed in the trading process. The best Forex risk management strategies rely on traders avoiding stress.



PUPRIME

MORE THAN TRADING

+248 4671 948

info@puprime.com

https://www.puprime.com/

Global Office