# 5 Best position sizing techniques to improve your trading

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Position Sizing Leverage


## There is no doubt that all traders want to capture big winning trades – those that double, triple or even quadruple your trading capital.

**But the fact is trades that deliver 5x, 10x or even 20x can be very rare.**

While they do come along, chances are your trading capital can be wiped out if you put all your money in a single trade thinking that it will be the big one.

Instead of risking all or a big majority of your trading capital in a single trade, you'll be better off utilising effective position sizing techniques within your trading strategy.

Most successful traders – whether they are trading the forex, index, share CFD or commodities markets – swear by the importance of position sizing in their success.

And why not? Without proper position sizing techniques you could be risking a big chunk of your trading capital. Ultimately, the bigger risk you take in every trade the bigger the chances of your trading account being cleared out.

While it is true that the opposite can sometimes happen – that the trade will deliver the much wanted huge win, most successful traders will tell you it is better to limit your position size rather than increase your risk unnecessarily.

Let's look at exactly what position sizing is and why it's so important, as well as dive into the best position sizing techniques you'll need to become

In trading, a position is the amount of currency (or other financial instruments) held by a trader. When we talk about open positions, a trader can be either long or short. A trader who closed their position(s) might also refer to this as being "flat/square".

For example, if you have an open long position of 1.0 Lot in EUR/USD, this means that you are long 100,000 EUR against the U.S. Dollar.

### Understanding positions

Having a long position means speculating on a price increase of a certain trading instrument. For example, if you go long XAU/USD, you are speculating on an increase of the Gold price in USD.

A short position involves speculating on falling prices of a certain trading instrument. The most important thing to highlight here is that you can speculate on falling prices of an asset that you do not actually own. For example, you can go short TESLA by using a CFD contract and profit from a price decline despite not owning the underlying instrument (the physical share).

## What is position sizing?

The simplest definition of position sizing is setting the correct trade size to buy or sell a certain instrument or calculating the dollar amount that a trader is going to use to open a new trade.

It sounds simple, but it can actually be quite complex. Before entering a trade, you should be aware of how much risk you are taking and how it will impact your trading account.

Furthermore, traders need to constantly monitor their positions and make sure things are under control. Remember, markets are moving quickly! In addition to that, traders need to keep margin requirements and margin stop out levels in consideration.

## Why is position sizing important?

As you can imagine, opening positions with random position sizes or based on gut feeling will eventually end in disaster. Position sizing is about preventing excessive losses. If you have a sound risk management plan and follow it, chances are you will not lose a significant portion of your capital on a single trade. It will also give you a chance to keep your focus on your account as a whole and all your open positions. Especially for short-term traders who have to react quickly to new developments, it can be easy to lose oversight and forget how much risk they already have running before they open further positions. This is why it is crucial - a good trader is also a good risk manager.

However, position sizing is not only about preventing excessive losses. It also gives you the opportunity to maximise your performance. A risk-averse trader who is only willing to risk a tiny percentage of his capital will have to accept the fact that they will never achieve notable returns. As you can see, position sizing is about finding the right balance - allowing yourself the opportunity to maximise your profit while preventing excessive losses.

Utilising proper position sizing with profit taking strategies will help traders develop the right approach to entering and exiting all trades.

## How to determine your position size?

Let's look at a couple of popular position sizing techniques you can implement in order to boost your trading and utilise position size effectively.

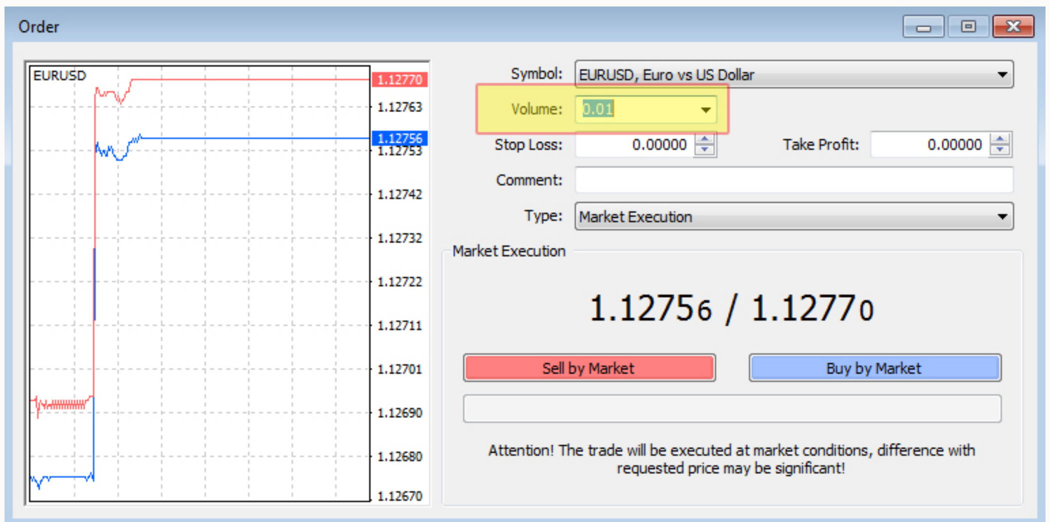
## Best position sizing techniques

**1. Fixed dollar value**

Fixed dollar value can be the simplest way to implement position sizing into your trading strategy. This may work particularly well for those who are new to trading or who have quite a limited amount of capital. All that it requires is to allocate a fixed dollar amount to every trade that you take.

one trade.

This automatically limits the risk you're taking per trade. It will also help preserve your capital in case the first few trades you take turn out to be losses.




### 2. Fixed percentage risk per trade

Fixed percentage risk per trade is the most commonly referred to position sizing technique used by traders. You risk a small percentage of your overall capital on each trade. It is an anti-martingale strategy, which is the preferred method for financial instruments like forex.

Depending on the financial instrument you're trading – e.g. forex, metals, oil or indices, – most successful traders would say a 1 - 2 percent per trade risk is a good rule of thumb.

Using the $10,000 trading capital example, you should only be risking $100 – $200 per trade if you use the fixed percentage risk per trade technique.

The great thing about this strategy is it gets you to focus on the percent risk instead of a dollar value. Then, as your capital increases from $10k to $20k, your 1% risk moves from $100 to $200 risk per trade. Likewise, if your capital decreases, you still risk just 1% but it will be a smaller dollar amount. Hence it is an anti-martingale strategy.

If you don't, you will soon find out the big risks you take in every trade can easily eat up your trading capital.

| Trading Capital | Risk at 1% | Risk at 2% |
|---|---|---|
| 10000 | 100 | 200 |
| 12000 | 120 | 240 |
| 14000 | 140 | 280 |
| 16000 | 160 | 320 |
| 18000 | 180 | 360 |
| 20000 | 200 | 400 |
| 22000 | 220 | 440 |
| 24000 | 240 | 480 |
| 26000 | 260 | 520 |
| 28000 | 280 | 560 |
| 30000 | 300 | 600 |

### 3. Contract size value

Many index and commodity traders use this technique to limit their risks. Contract size value is an effective way of controlling your risk while getting exposure to a fast-moving market.

Most trading providers, including Axi, offer different contract sizes for forex, indices and commodities. For example, most trading providers offer standard contracts, mini contracts and micro contracts.

Depending on your trading experience and your trading capital, you may want to trade the smaller size contracts first then you can scale up to the standard contract sizes later on.



### 4. Leverage

Many trading providers offer leverage from 20:1, 50:1, 100:1 or 200:1. Others offer more.

But the thing to keep in mind when it comes to leverage is you don't have to use the highest level of leverage. Just because it is on offer doesn't mean you have to use it.

It is better to use a lower level of leverage to make sure you are limiting your risk exposure.

If you leverage too much, you're increasing the risk of a capital wipe out or margin call in case a trade goes against you.

**5. Kelly Criterion**

Let´s look at the formula for Kelly Criterion:

**Kelly % = W - [(1-W)/R]**

It calculates the percentage of your account that you should risk (K%). It is equal to the historical win percentage of your trading strategy minus the inverse of the strategy win ratio divided by your profit/loss ratio.

The percentage you get from that equation is the position you should be taking. For example, if you get 0.05, it means you should risk 5 % of your capital per trade.

## How to calculate position size?

Aside from using a forex position size calculator, traders can calculate the position size as follows.

### Example of position size calculation

A trader with an account balance of $10,000 USD is primarily trading GBP/USD and does not want to risk more than 1 percent of his account per trade. He spotted a trade opportunity that requires a stop loss of 50 pips. He usually trades mini lots, which are worth $1 per pip.

The maximum risk he wants to take per trade is therefore: USD $10,000 x 0.01 = USD $100

To find the ideal position size we will use:

Pips risked * pip value * lots traded = Dollar amount risked

This gives us the following:

50 * 1 * lot traded = $100

The appropriate position is therefore 2 mini lots ($20,000 notional value).

## 3 Position management trading methods

### Pre-determined exit levels

Beginners might find it easier to set a stop loss and take profit order prior to entering a position, and sticking to it. Clearly, if you get stopped out all the time, you need to review your strategy and see what is going wrong. However, being disciplined and sticking to the pre-determined levels can help you in finding out if a strategy is actually working or not. You might have a good strategy, but if you close a winning trade way before it reaches the take profit level because you want to book in the profit, while keeping losses running as you don't want to book losses, you will still fail.

Chat

Experienced traders might opt for trading without any pre-determined exit levels, although this is definitely the riskier option. However, some traders could decide to only set a stop loss level when opening the trade, and manage this as the markets move. This style of trade management requires discipline and experience. It might work well for scalpers who are in-and-out of positions within minutes, or long-term traders who have plenty of time to figure out how they want to manage their position.

### Trailing stops

Trailing stops can work well in trending markets. For example, a trader being long Gold when the precious metal is in a strong uptrend might gradually move the stop loss order higher as the price is rising. With this, the trader is protecting his/her profits if the market suddenly reverses. However, traders must be careful not to use this method in ranging markets, as they would get stopped out frequently.

As there is no correct or incorrect way of managing trades, the best way to find a suitable method is to practice on a demo account. Traders who are impulsive and struggle to maintain discipline might opt for pre-determined exit levels. On the other hand, experienced traders might feel comfortable by not setting any pre-determined levels and managing their position as the market moves.

## What are the benefits of using position sizing techniques?

There is no optimal position sizing model. Just like with trading strategies, it all comes down to testing and exploring which method suits you best as trader.

It is important not to abruptly change or mix different position sizing techniques, but rather to have a proper plan in place and ensure consistency. A demo trading account is the perfect solution if you need more time to explore which method is the best fit for your trading style.

## How to reduce risk when using position sizing techniques?

Position sizing can reduce risk in different ways. For example, a trader who decides to take a large trade and risk 20% of his capital on it because he felt lucky or he thinks this is the big trade that will make him rich will struggle to keep a cool head. Most likely, he will start to feel immense stress once the position starts to move against him. Or, if it moves into his favour, he will panic and close the position to make sure he closes the trade in profit, even though the trade might continue to run 50 or 100 pips in his favour.

If you have a sound plan in place and are using appropriate position sizing techniques, you will end up with an amount of risk that is reasonable for you, and in return, it will be much easier to view your positions objectively. You will be in control, rather than reacting emotionally.

Stop loss and take profit orders are another way to manage your risk. Stop loss orders should not be placed randomly. If you are using a fixed value - let´s say 20 pips per trade - without considering where this level lies, you might end up getting stopped out more often than not. Instead, set your stop loss according to your trading strategy and adjust the position size based on how much you are willing to risk per trade.

### Conclusion

In conclusion, while as traders we all want to bag that big winning trade, it’s best to use position sizing techniques to ensure we can protect our trading capital. After all, we all want to be able to trade the next day (and that will be impossible if all your capital has been wiped out in a single trade).

And remember that oft-repeated market saying not to put all your eggs in one basket? That is not only about diversification. At the core of that wise saying is risk management – position sizing.

Don't have an account yet? Open a live trading account with Axi to access the world's top trading products and award-winning service.

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Milan Cutkovic has over eight years of experience in trading and market analysis across forex, indices, commodities, and stocks. He was one of the first traders accepted into the Axi Select program which identifies highly talented traders and assists them with professional development.


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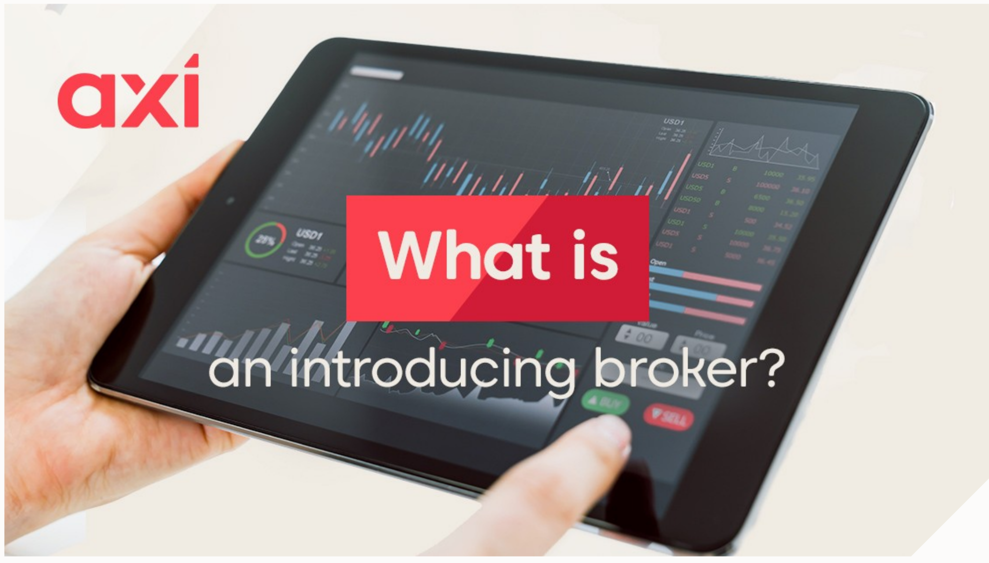


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