Market Talks
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FOREX · BEGINNER · LESSON 12 OF 15

Risk Management Basics

Why protecting your account matters more than any single trade, how to size every position from your stop loss, and how risk-to-reward, losing streaks and correlation fit together

12 min read 8 quiz questions with answer key

FOREX · BEGINNER · LESSON 12 OF 15

Risk Management Basics

IN ONE SENTENCE

Risk management decides whether a trader survives long enough to get good. The core rules are simple: risk only a small, fixed part of your account on each trade, usually 1% to 2%; place the stop loss where your idea is wrong; and calculate the position size from that stop. Add a sensible risk-to-reward ratio and a limit on total risk, and no single trade or losing streak can knock you out.

Why risk management comes first

No strategy wins every trade. Even good traders often win only around half of their trades, and every trader goes through losing streaks. What separates traders who last from those who do not is usually not how good their entries are, but how much they lose when they are wrong.

Risk management has one goal: to make sure that no single trade, and no normal run of bad luck, can seriously damage your account. If you survive, you have time to learn, improve and let a good strategy work. If you lose a large part of your account early, you may never get the chance.

This lesson brings together ideas from earlier lessons: pip value (Lesson 4), profit and loss (Lesson 5), leverage and margin (Lesson 10) and stop loss orders (Lesson 11).

Losses are harder to recover than they look

A loss and the gain needed to make it back are not the same size. If you lose 10% of your account, you need an 11.1% gain to get back to where you started. Lose 20% and you need 25%. Lose 50%, and you have to **double** what is left just to break even. After an 80% loss, you need a 400% gain.

This is simple arithmetic, but it explains why professional traders care so much about keeping losses small. Small losses are easy to recover from. Large ones can take years, or end a trading career.

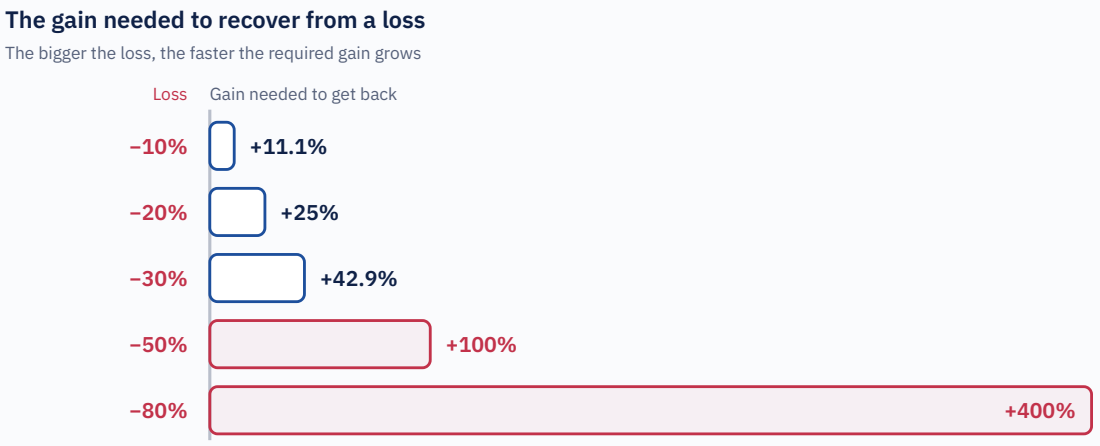


Figure 1. The gain needed to recover grows much faster than the loss. Keeping losses small keeps recovery easy.

Risk a small, fixed part of your account

The most widely used rule in trading is to risk only a small, fixed percentage of your account on each trade. For most traders, and especially beginners, that means **1% to 2%**, and many professionals use less.

"Risk" here means the amount you lose if your stop loss is hit, not the size of the position. With a $5,000 account and a 1% rule, you can lose at most **$50** on any single trade, whether it is EUR/USD, gold or anything else.

A fixed percentage has two big advantages. Your losses stay small and predictable, so no single trade can hurt you badly. And because the amount is a percentage, it adjusts automatically: as your account grows, so does your risk per trade, and if your account shrinks, your risk shrinks with it, which slows the damage during a bad period.

Position sizing: the most important calculation

Once you know how much you are willing to lose and where your stop loss goes, the right position size follows directly:

lots = money at risk ÷ (stop distance in pips × pip value per lot)

Anna has a $5,000 account and risks 1%, which is $50. She wants to buy EUR/USD with a stop loss 25 pips below her entry. For EUR/USD, one standard lot is worth $10 per pip (Lesson 4). So her position size is $50 ÷ (25 × $10) = **0.20 lot**. If the stop is hit, she loses 25 pips × $2 per pip = $50, exactly 1% of her account.

Notice what this means. Anna does not choose her lot size by feel, by how confident she is or by how much margin she has. The lot size is the **result** of her risk rule and her stop loss. Many brokers

and websites offer position size calculators that do this for you, which is especially useful for pairs whose pip value is not in dollars, such as USD/JPY or EUR/GBP.



Figure 2. Position size is the result of the account size, the risk rule, the stop distance and the pip value.

EXAMPLE: CHECKING LEVERAGE AFTER SIZING

Anna's 0.20 lot of EUR/USD at 1.0850 is a position worth $21,700. At 1:30 leverage it needs about $723 of margin, and her effective leverage is $21,700 ÷ $5,000, about 4.3 times (Lesson 10). Her margin level starts near 690%, far from any margin call. When you size positions from risk, leverage usually takes care of itself.

Stop loss first, then size

A common beginner mistake is to choose a stop loss by money: "I'll risk 20 pips because that feels about right". A stop loss should go where the market proves your trade idea wrong, for example just beyond a support or resistance level, or beyond a recent high or low. Technical levels like these are covered in the Intermediate level.

Once the stop is in the right place, the position size adjusts to keep the money risk the same. If the chart says your stop needs to be 50 pips away instead of 25, you trade half the size: $50 ÷ (50 × $10) = 0.10 lot. Your loss if the stop is hit is still $50.

This way every trade carries the same risk in money, whatever the distance to the stop. A wide stop is not more dangerous than a tight one, as long as the size is adjusted.

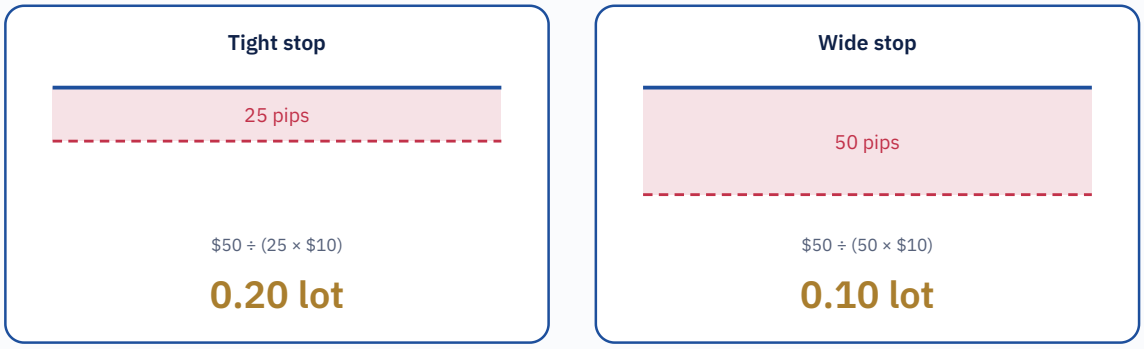


Figure 3. Same money at risk, different stop distances. The wider the stop, the smaller the position.

Risk-to-reward and win rate

Lesson 5 showed that winning often is not enough: the size of your wins compared with your losses matters just as much. Traders describe this with the **risk-to-reward ratio**: how much you could gain compared with how much you risk.

A trade with a 25-pip stop and a 50-pip target has a risk-to-reward ratio of **1:2**. If you risk 1% and win, you make 2%. That changes the win rate you need to break even, before costs:

- At 1:1, you need to win 50% of your trades.
- At 1:1.5, you need about 40%.
- At 1:2, you need about 33%.
- At 1:3, you need only 25%.

This does not mean bigger targets are always better. A distant target is reached less often, so the win rate falls. The aim is a realistic balance: targets the market can actually reach, with rewards that are clearly larger than the risk. Many traders look for at least 1:1.5 or 1:2 before taking a trade.

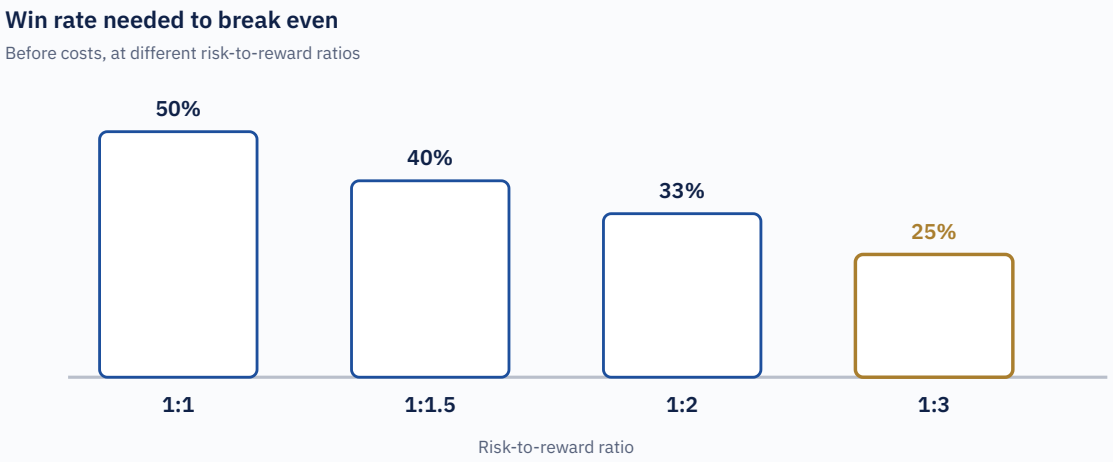


Figure 4. The bigger the reward compared with the risk, the fewer trades you need to win to break even.

Planning for losing streaks

Losing streaks are not a sign that something is broken. They are a normal part of trading. Even a strategy that wins 50% of the time will, sooner or later, lose eight or ten trades in a row.

Look at what ten losses in a row do to an account:

- Risking **1%** per trade, the account falls by about 10%. Painful, but easy to recover.
- Risking **5%** per trade, it falls by about 40%.
- Risking **10%** per trade, it falls by about 65%, and needs almost a 190% gain to recover.

The strategy is the same in all three cases. Only the risk per trade is different. This is the clearest argument for keeping risk small: it lets you survive the bad periods that every trader goes through.

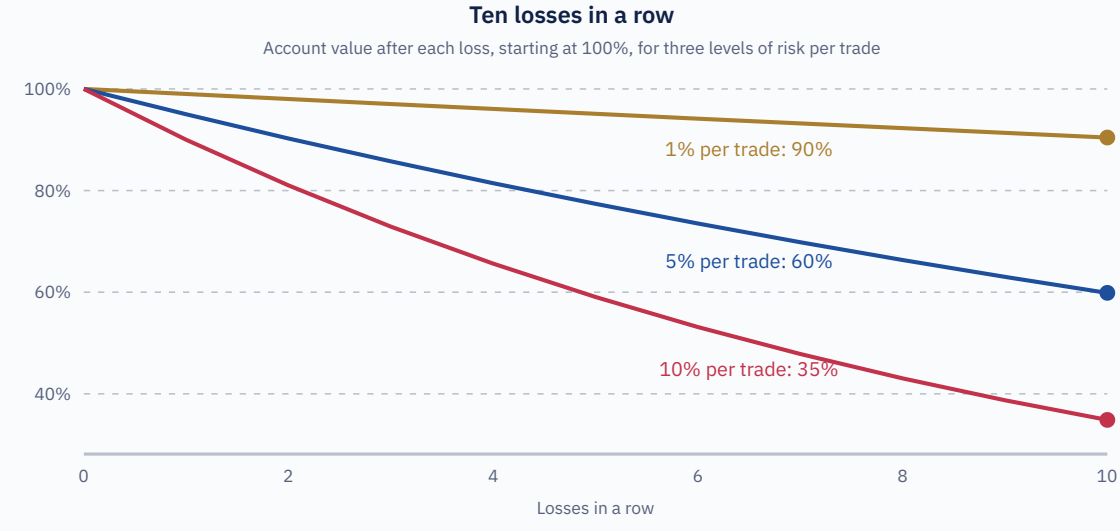


Figure 5. The same ten losing trades with three levels of risk per trade. Small risk makes losing streaks survivable.

Total risk, correlation and daily limits

Risk per trade is not the whole story. You also need to watch your **total open risk**: the sum of what you would lose if every open trade hit its stop loss. Many traders cap it at around 3% to 5% of the account.

Be careful with pairs that tend to move together. If you buy EUR/USD, GBP/USD and AUD/USD at the same time, risking 1% on each, you have really made one bet against the US dollar with 3% at risk. If the dollar strengthens, all three trades may lose together (Lesson 2).

It also helps to set simple personal limits: for example, stop trading for the day after losing 2% or 3%, or after three losses in a row. Most bad trading days get worse because of decisions made after the first losses, not before them.

Finally, keep a **trading journal**: entry, stop, target, size, result and why you took the trade. It is the only reliable way to see whether your risk rules are working. Lesson 15 shows a simple format.

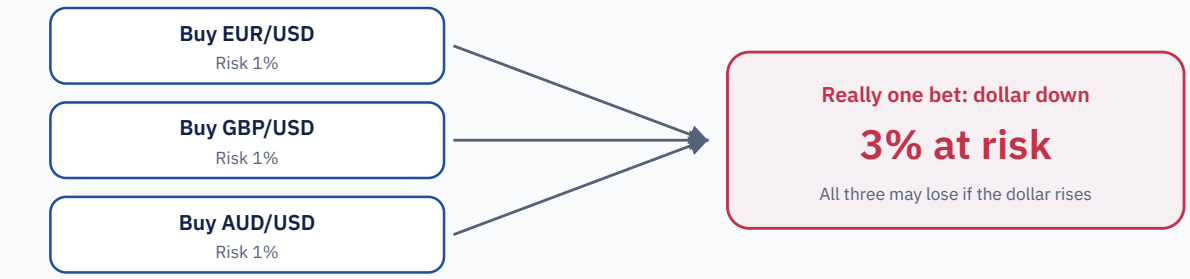


Figure 6. Three trades on dollar pairs in the same direction are, in effect, one larger bet.

Why this matters for traders

- **Decide your risk per trade and never break it.** 1% is a good starting point for beginners. Write it down.
- **Place the stop where your idea is wrong, then calculate the size.** Never the other way round, and never move a stop further away to avoid a loss.
- **Look for rewards clearly larger than the risk**, and check that targets are realistic for the pair and the time frame.
- **Gold needs the same rules, with care.** On XAU/USD, a $1 move is worth $100 per lot (Lesson 4), and stops are usually wider in dollars. Use the same formula with gold's own value per point, and the position size will be correct.

Key terms

Risk per trade	The amount you lose if a trade's stop loss is hit, usually set as a percentage of the account.
Position sizing	Choosing the trade size so that a stop loss hit costs exactly the planned risk.
Stop distance	The number of pips between the entry price and the stop loss.
Risk-to-reward ratio	The possible loss of a trade compared with its possible gain, such as 1:2.
Break-even win rate	The share of trades you must win to neither make nor lose money at a given risk-to-reward ratio.
Drawdown	A fall in account value from its highest point.
Losing streak	A series of losing trades in a row, a normal part of any strategy.
Total open risk	The combined loss if every open trade hit its stop loss at the same time.
Correlation	The tendency of two pairs to move in the same or opposite directions.
Trading journal	A record of every trade, with its plan, result and reasons, used to review and improve.

Key takeaways

1. Losses are harder to recover than they look: a 50% loss needs a 100% gain to get back to the start.
2. Risk only a small, fixed share of your account per trade, usually 1% to 2%.
3. Position size = money at risk ÷ (stop distance in pips × pip value per lot); place the stop by the chart, then size the trade.
4. A higher risk-to-reward ratio lowers the win rate you need: at 1:2 you break even by winning about one trade in three.
5. Plan for losing streaks, cap your total open risk, treat correlated pairs as one bet and keep a trading journal.

Test yourself

Circle one answer for each question. The answer key with explanations is on the next page. You can also take this quiz online at markettalks.info and see your score instantly.

1. **An account loses 50%. What gain is needed to return to the starting value?**

A 50%
B 75%
C 100%
D 150%

2. **With a $5,000 account and a 1% risk rule, what is the most you should lose on one trade?**

A $5
B $50
C $500
D $1,000

3. **You risk $50, your stop is 25 pips away and one standard lot of EUR/USD is worth $10 per pip. What is the position size?**

A 0.02 lot
B 0.20 lot
C 2.00 lots
D 0.50 lot

4. **The chart says your stop should be 50 pips away instead of 25. To keep the same money risk, what do you do?**

A Keep the same size
B Halve the position size
C Double the position size
D Move the stop to 25 pips anyway

5. **A trade has a 30-pip stop and a 60-pip target. What is its risk-to-reward ratio?**

A 1:1
B 1:2
C 2:1
D 1:3

6. **At a risk-to-reward ratio of 1:2, about what win rate do you need to break even, before costs?**

- A About 25%
- B About 33%
- C About 50%
- D About 67%

7. **Roughly how much does an account fall after ten losses in a row, risking 1% each time?**

- A About 1%
- B About 10%
- C About 40%
- D About 65%

8. **You buy EUR/USD, GBP/USD and AUD/USD, risking 1% on each. What is the main danger?**

- A There is none, the risks are separate
- B All three are really one bet against the US dollar, with about 3% at risk
- C The broker will close two of them
- D The spreads add up to 3%

Answer key

1 C

100%

After a 50% loss, half the money is left, so it must double, a 100% gain, to return to the start.

2 B

$50

1% of $5,000 is $50. That is the planned loss if the stop loss is hit.

3 B

0.20 lot

lots = $50 ÷ (25 × $10) = $50 ÷ $250 = 0.20 lot.

4 B

Halve the position size

Doubling the stop distance means halving the size, so the loss if the stop is hit stays the same.

5 B

1:2

You risk 30 pips to make 60, so the reward is twice the risk: 1:2.

6 B

About 33%

One win of 2 units pays for two losses of 1 unit, so winning one trade in three, about 33%, breaks even.

7 B

About 10%

Each loss is 1% of what is left, so ten losses leave about 90.4% of the account, a fall of about 10%.

8 B

All three are really one bet against the US dollar, with about 3% at risk

These pairs often move together against the dollar. If the dollar strengthens, all three can lose at the same time.

SOURCES

- CME Group, Trade and risk management: Proper position size: https://www.cmegroup.com/education/courses/trade-and-risk-management/proper-position-size.html
- CME Group, Trade and risk management: The 2% rule: https://www.cmegroup.com/education/courses/trade-and-risk-management/the-2-percent-rule.html
- IG, Pips in forex (pip values for position sizing): https://www.ig.com/uk/forex/fx-need-to-knows/pips-in-forex

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