

How to do position sizing for beginners–

Position sizing is a critical component of effective trading. It is a risk management method that assists traders in determining the appropriate number of shares or contracts to trade in any given position. This post will break down the notion of position sizing into simple steps.

Step 1: Define Your Stop Loss

The first and most important stage in position sizing is to establish your stop loss (SL). A stop loss is the price level at which you are willing to leave a trade to limit potential losses. Let us use an example to demonstrate this:

Assume you purchase a stake for 100 rupees. Your stop-loss price is set at Rs. 80. Now compute the difference between the entry and stop-loss prices:

$$100 \text{ (entry price)} - 80 \text{ (stop loss price)} = 20 \text{ rupees}$$

So, your stop loss is 20 rupees.

Step 2: Calculate Your Position Size

To calculate your position size, you'll need to use a simple formula involving your stop loss:

$$\text{Position Size} = \text{Risk per Trade} / \text{Stop Loss}$$

In this case, let's say you want to risk 2000 rupees on this trade, and your stop loss is 20 rupees:

$$\text{Position Size} = 2000 \text{ rupees} / 20 \text{ rupees} = 100 \text{ shares}$$

To keep your risk at 2000 rupees, you must purchase 100 shares. If your stop loss is hit, you will only lose up to 2000 rupees on this transaction.

Why Position Sizing Matters?

Position sizing is a critical aspect of trading for several reasons:

1. **Risk Management:** You avoid exposing your entire trading money to a single deal by selecting your position size based on your predefined risk. This safeguards you from catastrophic losses.
2. **Consistency:** Position sizing allows you to retain consistency in your risk management strategy. By modifying your position size, you can manage your risk regardless of the stock's price or volatility.
3. **Emotion Control:** Knowing your position size beforehand allows you to trade without being influenced by emotions. It inhibits rash actions motivated by fear or greed.
4. **Capital Preservation:** Position sizing correctly ensures you have adequate capital to capitalize on future chances. It keeps you from blowing up your trading account with large positions.

5. Long-term Success: Successful traders recognize that capital protection is critical to long-term success. Position sizing is an effective strategy for accomplishing this goal.

In Conclusion

Position sizing is a straightforward yet critical concept in trading. It assists you with risk management, consistency, and making sensible decisions. By estimating your position size and setting your stop loss in advance, you may trade confidently, knowing that you have a well-defined plan to limit your losses and preserve your cash. Remember that risk management is the game's name in trading, and position sizing is your plan for achieving it.