



# A NEW TECHNIQUE IN MONEY MANAGEMENT

---

By **Tony Juste**  
Head of Trading, FOREXSTREET,S.L.

I International Traders Conference, Barcelona  
October 2007



# Table of Contents

---

- What Money Management means for a trader
- The 'Effective Cost' Technique
- Case Studies

# What Money Management means for a trader



- Appearing as 'MM', it helps the trader determine:
  - Position Size
  - Timeframe
  - Profit / Loss Targets
- MM works hand in hand with the trading system of a trader. In fact, it determines the 'style' of the trader.

# What Money Management means for a trader

- There are many different 'MM' techniques:
  - Pyramiding → Trailing profit-stop
  - Dollar-cost average / Average Down → Adding on losses, trying to get a better entry price to bail out of a position on the best possible condition
  - Fractional lot position → the trade starts with a pre-determined number of lots and takes out lots as profit levels are reached
- Each technique may be valid for a trader and be useless to another. The key when choosing a 'MM' technique is **self-understanding**.



# The 'Effective Cost' Technique

---

- A technique to prove that trading based on indicators / technicals (of common use) may be profitable.
- Makes the most of a trader
  - Focus on the 'business' of a particular position
  - Forces him/her to be flexible and adapt to market changes
  - Market is the one proving the trader right/wrong, regardless of the system used
  - Bad positions can turn profitable → confidence



# The 'Effective Cost' Technique

---

- It is a defensive technique. It is based on the probabilities of success of a particular position initiated.
- It was built to prepare for the worst-case trading scenarios.
- It allows for moderate profits while attempts to keep losses under control.



# The 'Effective Cost' Technique

---

- Allows a trader to determine the stop-loss level:
  - Based on equity drawdown
  - Based on technical triggers → strongly recommended



# The 'Effective Cost' Technique

---

- The technique considers each taken position as individual. It works on the basis of opening & cutting positions.
- P&L is calculated per open position. If there are 2 or more open positions in the same pair and direction they will equally be treated separately (individually).
- A pre-determined maximum of open positions in the same direction is set initially for the 'worst case' scenario.



# The 'Effective Cost' Technique

---

- The 'same position maximum' (SPM) is set before any first position in a currency pair is taken.
- The technique works on the basis of pre-set losses to understand maximum risks associated with a particular position.
- A recommended number of 'same positions' is set to 5. However, risk tolerance (appetite) and style of trading will determine the 'maximum'.



# The 'Effective Cost' Technique

---

- The technique should not be compared with the 'Dollar-cost' average one.
- It is aimed at protecting/helping counter-trend, indicator-based traders, when facing difficult trading conditions.
- Improves the % probability of success of any position. Allows to combine timeframes within a position.



# The 'Effective Cost' Technique

---

- Works as a stress-reducer in difficult trading environments. Demands that the trader stays flexible all the time.
- It allows a trader to be worked into a position by the market and to be worked out of that same position by the market. No external pressure.
- It simplifies the calculation of a trader's performance.



# The 'Effective Cost' Technique

---

- 'Same position maximum' (SPM)  
Calculation:

- SPM =

timeframe X range (pips)

---

max. % equity drawdown allowed X lot size



# The 'Effective Cost' Technique

---

- Position size calculation (when basing stop-losses on equity drawdown):
  - Account size: \$50,000
  - Maximum equity drawdown: 6% (\$3,000)
  - Assume SPM = 5 ( $\$600 \times 5 = \$3,000$ )
  - Initially, the worst of a single position can reach is \$600, i.e., 60 pips with 100K lot size, or 120 with 50K size or 240 pips with 25K lot size.



# Case Studies

---

- The following case studies are based on different trading approaches and will show the practical use of the 'Effective Cost' technique.

# Case 1: The Ideal Situation

USD-CHF - USD-CHF - Fin de día 1 días H: 00:05 A: 1,1693 M: 1,1733 m: 1,1655 C: 1,1672 P: 1,2595 V: 0 F: 19/10/2007

## CASE 1: LONG POSITION IN USD/CHF BASED ON CHANNEL TRADING

After confirming with 4 contact points an uptrend channel, a trading opportunity arises at point 'X'. It is a long position on test of the lower line of the channel, with target at channel's middle line. Target is met without difficulty.

EFFECTIVE COST TECHNIQUE IS NOT NEEDED HERE.



# Case 2: Effective Cost at Work

USD-CHF - USD-CHF - Fin de día 1 días H: 00:05 A: 1,1693 M: 1,1733 m: 1,1655 C: 1,1672 P: 1,3226 V: 0 F: 19/10/2007

## CASE 2: COUNTER-TREND SHORT POSITIONS AGAINST UPTREND CHANNEL

After identifying (using 5 contact points) an uptrend channel and its projected line, we start taking short positions based on dynamic resistances both at the upper line of the original channel and at the projected line. The positions taken and the overall result are as follows:

### Position 1: Short at 'X' - target is channel baseline.

- (A) Short @ 1.2174 (I)
- (B) Price climbs - Short @ 1.2260 (II)
- (C) New target - upper line of the channel (\*)
- (D) Price falls to 1.2210, closes @ 1.2225 next day  
Closing Short(II) @ +30
- (E) The new effective cost of Short (I) is:  $1.2174 + 30 = 1.2204$
- (F) Target met next day - 1.2189 (+15)

### Position 2: Short at 'XX' - pays target fast

### Position 3: Short at 'Y' target still is channel's upper line

- (A) Short @ 1.2388 (I)
- (B) Price climbs - Short @ 1.2475 (II)
- (C) Price climbs - Short @ 1.2557 (III)
- (D) Prices down to 1.2502 close, closing short (III) with +55  
New effective cost for short (II) is  $1.2475 + 55 = 1.2530$
- (E) Prices make a 1.2450 low, we close short (II) @ 1.2465 for +65 pips.  
This leaves effective cost of short (I) @ 1.2453
- (F) Target is met 2 days later @ 1.2415. Position close: +38 pips

Note: Positions from 'Z' ('Z', 'ZZ', 'ZZZ') onwards will be taken at the test of the projected line, as the upper line of the channel, now serving as middle line, has not been broken

(\*) Because when the upper line of a channel breaks, one assumes that momentum will build-up faster.



## Comments on Case 2

---

- Case 2 is a typical case of 'hostile' trading environment for a counter-trend trader.
- Where is the stop-loss? At the % equity drawdown set (beforehand) by the trader or, what's preferred, **on market technicals** (read next slide).
- Staying flexible and grabbing 'what's on the table' at any given time is mandatory.



## Comments on Case 2

---

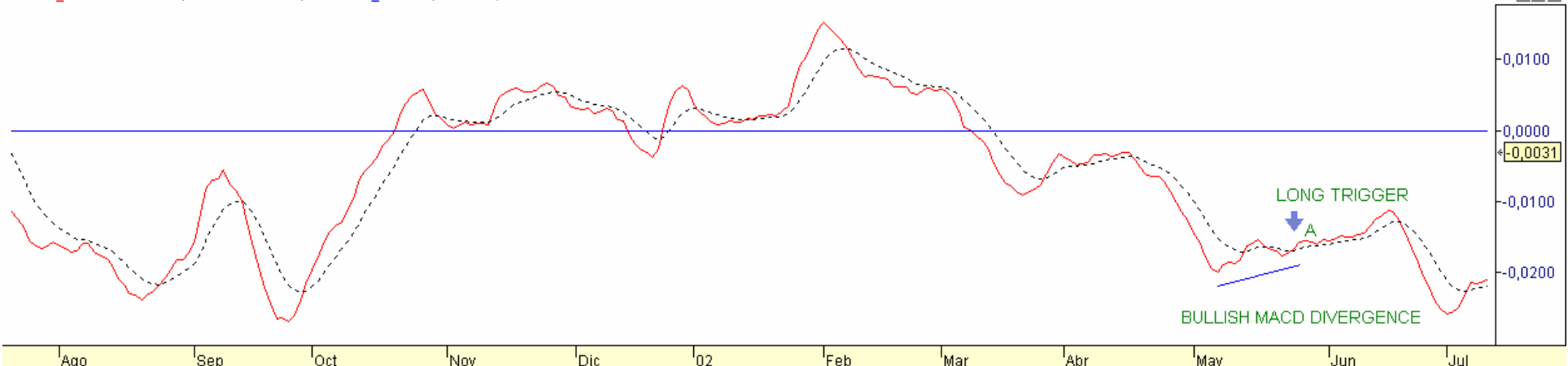
- Stop-loss triggers based on technicals:
  - Check examples 'Z' and 'ZZZ'
  - As prices continue to trade out of the projected line, stop-loss can easily be set @ 2 consecutive closings out of bounds.
  - After being stopped out, look for prices to get back into the 'range' to establish technical short positions again.

# Case 3: Indicators in trouble

USD-CHF - USD-CHF - Fin de día 1 días H: 23:58 A: 1,6628 M: 1,6688 m: 1,6534 C: 1,6540 P: 1,7271 V: 0 F: 21/08/2001



MACD\_USD-CHF MACD: -0,0238 MediaSIG: -0,0209 Band\_MACD: 0,0000 P: 0,0739





## Comments on Case 3

---

- This is an example of a losing position, with losses dramatically reduced by using the 'Effective Cost' Technique.
- The position, taken from start to finish, would've netted a 400 pip loss → 1.5820-1.5420.
- By using the technique, we 'gained' 170 pips to that failed indicator's trigger. We almost cut losses by half.



## Comments on Case 3

---

- This is an example of the 'worst case' scenario, where a high % odds success technical trigger like a daily MACD divergence turns into a losing position.
- The 'Effective Cost' technique allows to reduce the stress out of the loss while reducing the impact of the failed trigger.
- This allows to focus on the next trigger as it comes. Money lost is not the focus (should not be, anyway).



# Final Thoughts

---

- The 'Effective Technique' shows that technical traders using common indicators can have a profitable track record.
- It proves that with its use, there is no need for extremely complicated systems to keep a positive track record using common tech tools.
- It takes the noise out of market conditions, focusing on one's ability as a trader. That is one of its main strengths, as it makes the most of a trader.