

A stylized illustration of a pyramid with playing cards and a hand holding a card. The pyramid is dark blue and features several playing cards: a spade, a club, a heart, and a diamond. A hand is shown holding a card. The background is a gradient of blue and purple.

Risk Management in Crypto Trading:

Written by Superorder.io

This article can help both expert investors and green beginners to reduce the unexpected market's influence. It also will be a goldmine for unlucky traders who fail again and again. Risk management is your lifeline. Proper strategies protect many market players from losing all assets thanks to understanding causes and consequences. Just grasp a few concepts and learn to stick to the plan, that's it! And use this guide.

Risk Management in Crypto Trading: How to Win Even When You Lose

RISK

MANAGEMENT

Here's a question: do you consider yourself a successful trader?
And here's another one: do you lose money when trading?
Without paradoxes, it's typical if you responded positively to both questions. The catch is that even the most skilled professionals face losing streaks, unprofitable deals, and just bad days. It's possible to do everything right and still fail. Risks and damages are inevitable.

Written by Superorder.io

Understanding Risks and Ways to mitigate them

Risk is a chance of any negative event related to your current activity. Thus, risk in crypto trading is a chance of undesired outcome, hence, losses. Probably, you heard something like “oh, there's a 50% risk to fail this short position because Bitcoin may go up the next week”. Exactly.

In the crypto universe, risks are everywhere. Facebook may announce the launch of its coin and the entire market will turn green destroying bears completely. American regulators may refuse another Bitcoin ETF initiative and FUD will rise forcing investors to sell and driving prices down eventually.

There are four major financial risk types related to the crypto sphere:

Credit: when a party behind the cryptoproject fails to fulfill the obligations.

Legal: when a party faces regulative issues, e.g. ban in a specific country.

Liquidity: when a trader can't convert the entire position to fiat.

Market: when prices of coins move up or down depending on your open positions.

Operational: when traders can't, actually, trade, deposit or withdraw money.

In a nutshell, all risks lead to financial losses.

Thus, let's learn how to mitigate them by studying **main risk management principles.**

Main Risk Management Strategies



First and foremost, remember the golden rule of any trading: don't risk more than you can afford to lose. Don't believe a man who says that he invested the shirt off his back and suddenly became a millionaire. Experienced investors always have reserves.

For crypto traders, it's recommended to use no more than 10% of the monthly revenue or the actual budget. Later, you can add more but never ever trade for borrowed money, it's another rule. That's why margin trading is for pro guys only.

Finally, you should be aware of three defining ideas that work for each risk management strategy. They're universal and excellent for newcomers.

1. Position Sizing

It's pretty tempting to invest 30%, 50% or even 100% of your trading capital to make one single deal. Bullish markets can force you to do this after a series of successful trades. Nothing can be more disruptive, though.

Please, know the classic and don't put all your eggs in one basket. Learn the position sizing.



Enter Amount US Risk Amount

The most important concept to understand now refers to two different amounts.

Firstly, you have the money you invest in every single deal. It's the size of each new order regardless of its type. On the other hand, there is the money at risk, e.g. how much you can lose in the case of fail. The risk percentage is described in the next section. As for the enter amount, there's a simple equation to define it:

$$A = ((\text{Stack Size} * \text{Risk per Trade}) / (\text{Entry Price} - \text{Stop Loss})) * \text{Entry Price}$$

Let's clear it with example. Say, we want to buy BTC with USDT with a target at \$13,000. Thus, parameters will be like:

Stack Size: \$5,000
Risk per Trade: 2%
Entry Price: \$11,500
Stop Loss: \$10,500

And we get:

$$A = ((5,000 * 0.02) / (11,500 - 10,500)) * 11,500 = 1,150$$

The amount you can invest in this given deal is \$1,150 or 23%. However, you risk for only 2% because you have a Stop Loss that will close the order upon reaching the specified level. Take your time now.



Don't worry, we will cover risk percents in the next section and also will talk about Stop Losses a bit later. Further, it's about the amount at risk everywhere we talk about percentage and sums.

Elder's "Sharks" and "Piranhas"

Basically, the concept of sizing stands for diversifying investments.
Dr. Alexander Elder in his guide suggests two rules:

2% per trade.

Sometimes, you want to risk big. The moment of failure Elder compares with a shark bite when you lost a significant part of your budget.
Thus, he recommends limiting every single position to 2%.

6% per session

During loose streaks, you can spend everything step by step. This situation is like an attack of piranhas. Elder says to limit the trading session to 6% and take a break for a day at least after reaching this level.

As a result, you may get no more than three open positions per 2% each or six ones per 1%, etc. Limits often lead to a reverse compounding effect according to which your losses become smaller and smaller with each subsequent unprofitable deal. Of course, you can adapt these rules with new experience but they're great for the beginning.



Kelly Criterion

Being one of the main strategies for investors, the formula proposed by John Larry Kelly Jr. in 1956 is a gem. Unlike the previous equation, it suits the long-term trading. It helps to define the capital's percentage to bet regularly:

$$A = (\text{Success \%} / \text{Loss Ratio at Stop Loss}) - ((1 - \text{Success \%}) / \text{Profit Ratio at Take Profit})$$

Again, let's use examples. We want to buy BTC, similarly to the previous case. To get a percentage of success, simply divide the number of profitable deals by the total number of your trades. Features of this deal are as follows:

- **Stock Size:** \$5,000.
- **Invested Amount:** \$1,150.
- **Success %:** 60%.
- **Entry Price:** \$11,500.
- **Stop Loss:** \$10,500.
- **Loss Ratio:** 1.10.
- **Take Profit:** \$13,000.
- **Profit Ratio:** 1.13.

As a result, we get:

$$A = (0.6 / 1.10) - ((1 - 0.6) / 1.13) = 0.19$$

It means that you should risk no more than 19% of the entire capital of \$5,000 to reach the best possible outcomes in a series of deals. However, experts suggest investing from 0.3A to 0.5A or up to 10% in our case because of the market volatility.

Overall, the Kelly criterion is a bit difficult stuff. For the beginning, you can follow our first formula to set enter amounts and use the ideas of Alexander Elder to define risk amounts. It should be enough.

Risk/Reward Ratio

The next concept to talk about features the actual level of risk and its comparison with potential returns. Obviously, the riskier a given position is the more profits it can generate. Our task is to understand when you still can enter the game and when it's better to avoid trading because of too bad ratio.

This parameter is calculated by another formula:

$$R = (\text{Target Price} - \text{Entry Price}) / (\text{Entry Price} - \text{Stop Loss})$$

Let's remember the previous example where we buy BTC.
Its key features for the equation are the same:

- Entry Price: \$11,500.
- Stop Loss: \$10,500.
- Target Price: \$13,000.

And the ratio will be

$$R = (13,000 - 11,500) / (11,500 - 10,500) = 1.5$$

The ratio of 1:1.5 (you can spot the entry form like simply 1.5, too) is somewhere between acceptable and good. Thus, either our target is too close or our Stop Loss is too far.

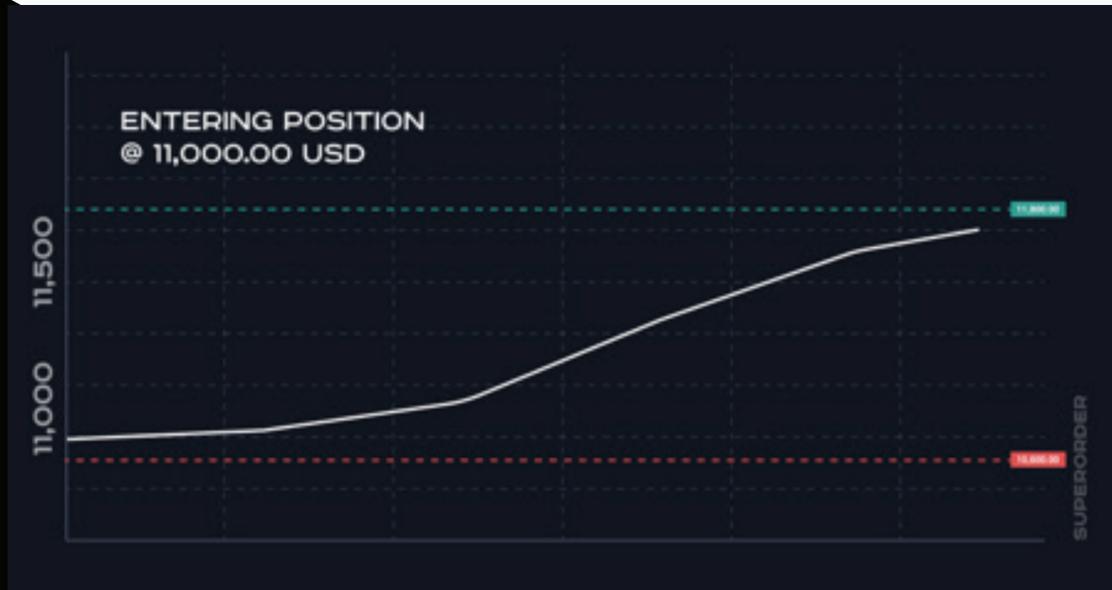
Let's modify the initial conditions to get:

- Entry Price: \$11,500.
- Stop Loss: \$11,000.
- Target Price: \$14,500.
- Entry Price: \$11,500.

$$R = (14,500 - 11,500) / (11,500 - 11,000) = 6$$

Here, we get the ratio of 1:6 and it's more than perfect. Usually, you should never trade when the risk/reward ratio is lower than 1:1, consider avoiding the deal at 1:1, enter at 1:2, and definitely invest at 1:3 and higher.

Stop Loss + Take Profit



Finally, it's time to look at Stop Losses. These orders are mentioned in the previous paragraphs but how do they work, actually? It's simple.

Stop Loss is an order that closes an open position after a price decreases to a specified barrier. Take Profit works the same way but it liquidates open orders when prices rise to a set level. Always use Stop Losses. They can literally save you a fortune because they don't let you be involved in unprofitable deals. Take Profits are highly desired, too.

Some traders try to hold assets as long as they can. It's the wrong way. The secret is that you drown yourself by holding decreasing coins.

After 10% loss, you will need 11% to return to the initial amount, but 50% damage means that you have to invest 100% to recover. And 90% loss means tremendous 900% of the initial deposit.

HINT

You can use Trailing Stop Losses and Take Profits that follow the rates' changes without manual control.

These cool things aren't usually available via crypto exchanges.

However, platforms like API trading terminal **SuperOrder** support Trailings.

TAKE PROFIT 1,500

STOP LOSS 1,000

1 : 1.5

TAKE PROFIT 3,000

STOP LOSS 500

1 : 6

Winning Strategies

Apart from the points mentioned before, there are some useful tips & tricks for traders. When you begin with position sizing, measuring risk/reward ratio, and combining correct orders, don't forget about minor stuff that can save the game. Below, find the list of insights for profitable strategies that can help even complete newbies.

- **Accept failures.** Losses are normal. Bad days are normal. It's impossible to trade perfectly all the time. Nevertheless, it's possible to mitigate risks and reduce expenses if you have a plan and stick to it. Don't gamble and don't pretend to be a god of trading. Just be persistent to make regular yet not the largest profits.
- **Consider fees.** Crypto trading often comes with extra charges that newcomers don't notice often. Exchanges list trading fees, deposit fees, withdrawal fees, leverage fees, and so on. You should conduct research on extra expenses and consider them in your calculations all the time.
- **Focus on the win rate.** This one may sound obvious but a lot of traders forget about it. As long as you earn more often than you lose (both in number of deals and the sums), you're successful. Be sure to keep the win rate above 50% so you will increase earnings consistently.
- **Measure drawdown.** This term stands for the total reduction of your initial funds after a series of bad deals. Let's say, you lost \$1,000 out of \$5,000 so your drawdown is 10% now. The higher it is the more money you need to recover (yeah, 900%) so consider stopping at 6%, as Dr. Elder says.

LOSS	GAIN REQUIRED TO RECAPTURE LOSS	LOSS IN BTC	GAIN IN BTC
-5.00%	5.26%	-0.05 BTC	0.0526 BTC
-10.00%	11.11%	-0.1 BTC	0.1111 BTC
-25.00%	33.33%	-0.25 BTC	0.3333 BTC
-50.00%	100.00%	-0.5 BTC	1 BTC
-75.00%	300.00%	-0.75 BTC	3 BTC
-90.00%	900.00%	-0.9 BTC	9 BTC

SUPERORDER