

Module 15 · Printable reference

Risk Management and Trading Psychology

Key concepts, worked examples and risk reminders. Use alongside the full free course.

177 Risk budget

Set a limit on planned exposure relative to available capital.

Example: Capital 100,000 and 0.5% risk budget give 500.

Check: Capital 100,000, illustrative risk fraction 0.5%: budget?

Answer: 500.

Caution: A planned budget cannot prevent gaps.

178 Position sizing

Divide intended risk budget by per-unit planned loss and apply exposure caps.

Example: Budget 500 and stop distance 5 yield 100 shares before costs.

Check: Budget 500, stop distance 5, additional estimated cost 1 per unit: units?

Answer: 83, rounded down before other constraints.

Caution: Round down and account for liquidity.

179 Risk reward

Compare potential target gain with planned loss.

Example: Target distance 15 and stop distance 5 produce reward-to-risk 3.

Check: Reward 15 and risk 5: cost-free break-even win rate?

Answer: 25%.

Caution: A high ratio alone says nothing about hit rate.

180 Expectancy

Expected net outcome combines probabilities and outcome sizes.

Example: 40% wins of 300 and 60% losses of 100 give gross expectancy 60.

Check: 40% × 300 wins, 60% × 100 losses, cost 20: net expectancy?

Answer: 40 per trade under those assumptions.

Caution: Estimated probabilities are uncertain.

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Educational only · Hypothetical examples · Independent review pending

181 Drawdown

Drawdown measures decline from an equity peak.

Example: Peak 120,000 and current 96,000 imply 20% drawdown.

Check: A 50% drawdown requires what recovery gain?

Answer: 100%.

Caution: Recovery requires a larger percentage gain.

182 Risk of ruin

Risk of ruin concerns probability of reaching an unacceptable capital threshold.

Example: Repeated large fractional losses can deplete capital rapidly.

Check: Ten consecutive 10% losses leave what fraction of initial capital?

Answer: 0.9^10, approximately 34.9%.

Caution: Simple independent-trade models may understate clustered losses.

183 Correlation risk

Assets moving together may produce simultaneous losses.

Example: Two highly correlated index positions share exposure.

Check: Can assets with low historical correlation fall together during stress?

Answer: Yes.

Caution: Historical correlations can change in stress.

184 Loss aversion

Loss aversion can encourage holding losers or prematurely closing winners.

Example: A trader moves a stop because realizing a loss feels uncomfortable.

Check: Is moving a stop after an adverse move automatically rational?

Answer: No; it may violate the predeclared risk rule unless a documented condition applies.

Caution: Use predefined decisions and document deviations.

185 Overtrading

Excessive trades can increase costs and reduce rule adherence.

Example: Twenty extra trades costing 50 each consume 1,000.

Check: Extra 20 trades at cost 50 each: added cost?

Answer: 1,000.

Caution: More activity does not necessarily improve expectancy.

186 Trading journal

A journal records decisions, execution and outcomes for review.

Example: Record setup, timestamp, planned risk, fill and exit reason.

Check: Why store the initial rationale before outcome?

Answer: To reduce hindsight rewriting and measure decision quality.

Caution: Avoid rewriting the initial rationale after seeing the outcome.

Further reading

SEBI investor education: investor.sebi.gov.in · NSE: nseindia.com. References for background only; no endorsement or independent validation is implied.

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