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Technical Analysis Masterclass- Part 2

'Entering the trade'

Entering a trade without ascertaining a certain things is gambling.

In this masterclass we will learn the pre-requisites to enter a trade.

DON'T ENTER A TRADE WITHOUT DETERMINNG THE FOLLOWING.

Please share.

We understand what reward to risk (popularly called risk to reward) is.
It will be denoted by R:R.

We will also try to bust a few myths about R:R and how to avoid losing trades.

Before entering a trade, you need to determine 3 things.

1. Entry trigger
2. Stop loss
3. Target

1. Entry trigger = Reasons for entering a trade. There could be multiple reasons or a single reason for entry.

Generally a set of reasons AKA confluence is a higher probability trade and a generally a safer entry.

Example of an entry trigger.



2. Stop Loss.

The price in the opposite direction of the trade where the trade is exited, at a loss.

At this level, the reason for the entry becomes invalidated according to TA and the price can then move in the opposite direction, probabilistically.



3. Target is the possible price level that the asset might touch based on previous trends or confluence AND where a possible reversal could occur.

Target is the next path of least resistance from where the price might reverse.

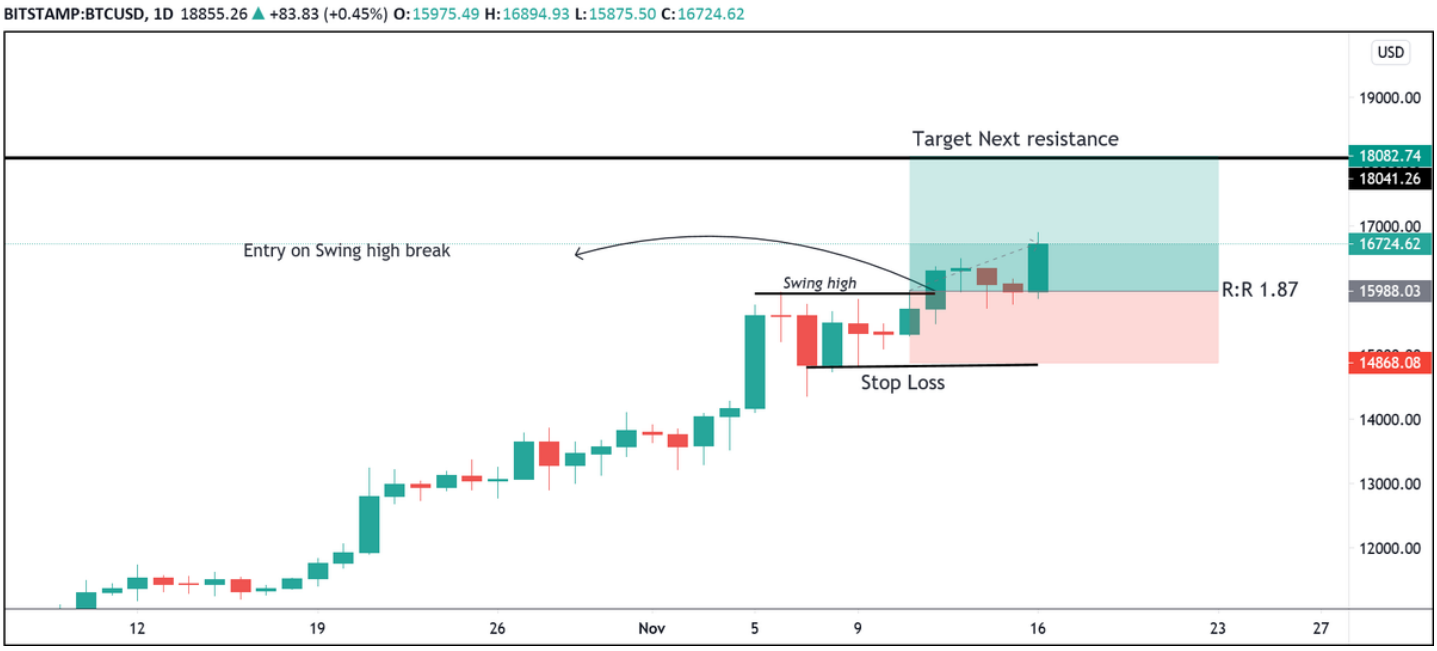
We will always ONLY use TA to determine all 3.



A combination of the three coming together forms R:R.
We will try to understand what really R:R in this thread.

R:R simply is the ratio of the distance between entry and target, and entry and the stop loss.

Here is an example of the R:R ratio

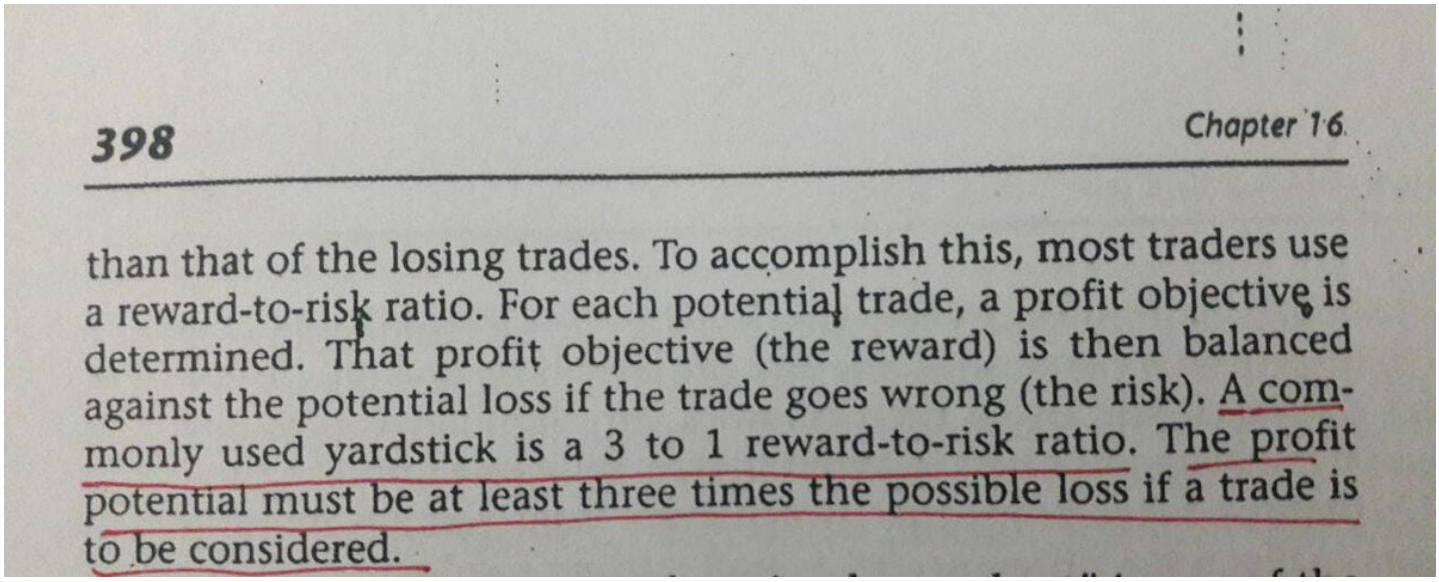


R:R is generally denoted in ratio form such as 2:1 or 3:1.
If the target is 10% above the entry and the stop loss is 5% below the entry, the RR is 2:1

YOU SHOULD NOT BE ENTERING A TRADE UNLESS THE R:R IS KNOWN.

Myth.
A fixed minimum R:R is necessary for taking a trade.

Even Murphy in his book has advocated for the same but in my opinion it is a wrong benchmark to have.
Sticking to a fixed RR can prevent us from entering a high probability trade at times, eg at confluences.



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than that of the losing trades. To accomplish this, most traders use a reward-to-risk ratio. For each potential trade, a profit objective is determined. That profit objective (the reward) is then balanced against the potential loss if the trade goes wrong (the risk). A commonly used yardstick is a 3 to 1 reward-to-risk ratio. The profit potential must be at least three times the possible loss if a trade is to be considered.

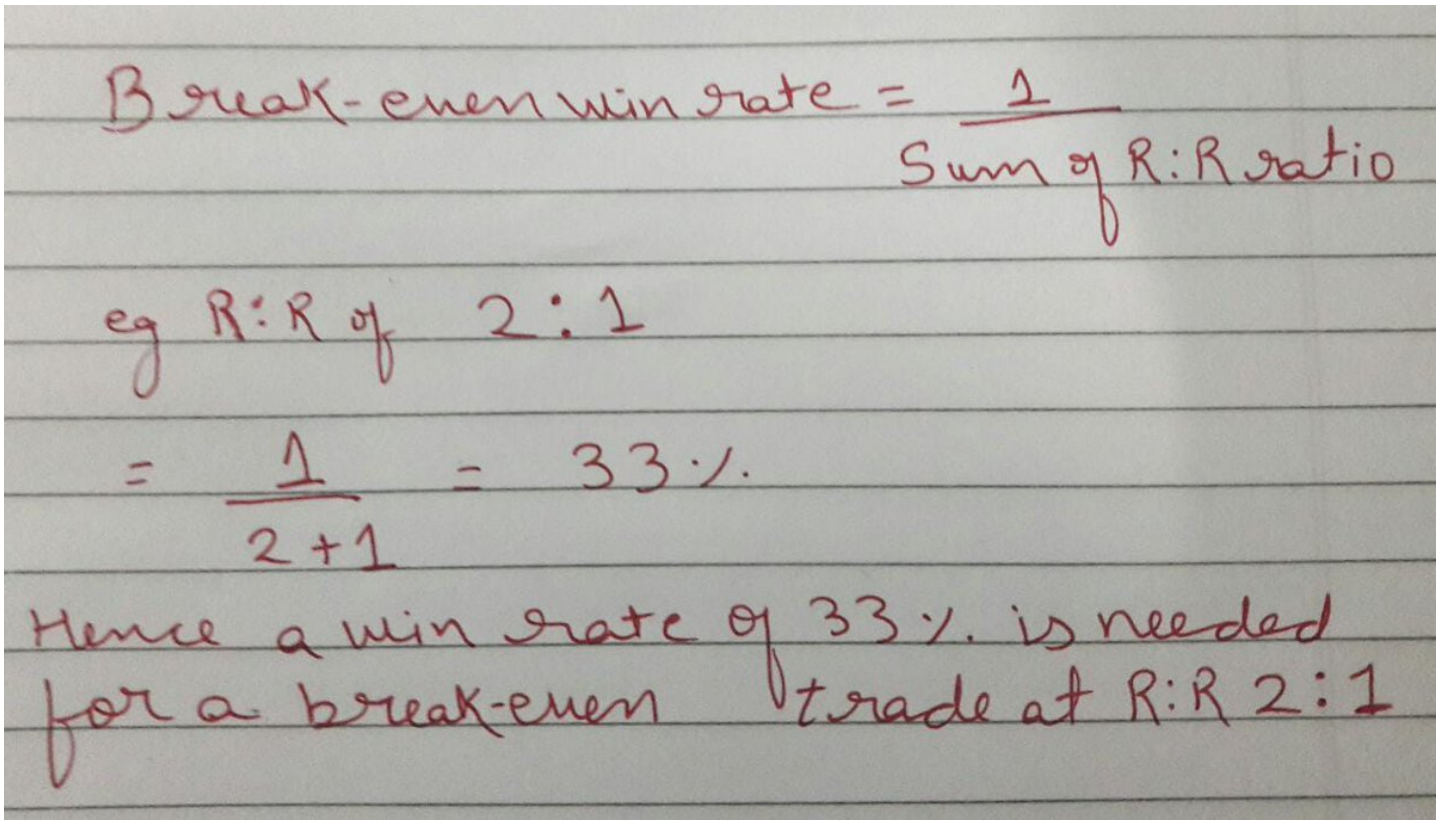
So what is the right way to use R:R and how do traders with low Win rate turn out to be profitable?

Profitability depends on 2 factors. R:R and win rate.
Study the chart below.

Your historical winrate	Minimum reward:risk ratio
25%	3 : 1
33%	2 : 1
40%	1.5 : 1
50%	1 : 1
60%	0.7 : 1
75%	0.3 : 1

The above chart describes how much R:R is needed for a certain level of win rate.
Eg. If your win rate is 50%, you will be at breakeven at a R:R ratio of 1.

The formula to calculate the same is as below.



The above might seem confusing but the crux of the matter is,
-Test your strategy
-Find your win rate
-Use only the R:R setups which suits your win rate.

Eg. Always choose a trade with R:R greater than 2 if win rate is around 33%

Conclusion.

1. Find your win rate. Choose trades with R:R which suits your win rate.
2. Base the above only on TA.
3. Never enter a trade without knowing the target and SL.
4. Don't get stuck with a fixed R:R.

The completes the Risk to reward tutorial.

It is a must use to tool to avoid trades that don't suit our win rate. This gives a HUGE trading edge as most of the lower win probability trades can be avoided.

We will learn stop loss placement next.

Please share if this was useful.