Twitter Thread by Madan



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Subjectivity in risk management --

I would like to briefly talk about risk mgmt in this thread (something that is not talked about much anywhere else)

The whole question of risk management is far from an objective subject.

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One need at least one subjective piece of the puzzle to put it together, and that is an individual's acceptance to risk.

Now that is subjective, meaning there is no rule that says how risk averse you should be. That is an integral part of your emotional makeup ■

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The problem is, human nature does not operate to maximize gain, but rather to maximize the chance of gain, i.e., maximize the # of winning trades & minimize the # of losing trades.

The result is, not only is risk controlled, but profitability is also controlled ■

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In other words, playing it safe can be just as bad as taking too much risk, because you are not optimizing your winning trades nor the days with extended ranges.

Sure, it's possible to develop trading idea based on tick charts(scalping) that will on average be profitable

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However, the average profits on individual trades from such methodologies are microscopic, and the trades they generate are so many that it not reasonable to scale up these strategies.

Dont even get me started on costs and slippages here ■

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From modern portfolio theory POV, we can think of the trading profit on any given trade, as the compensation we receive for the risk we took on the trade.

Basically, the mkt demands a premium from the trader for taking less risk & rewards him with reduced profitability ■

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Ultimately, it is not what the trader knows, but who he is. The really profitable traders are able to ignore/weaken their natural tendencies to do what feels comfortable & instead, do what is essential, to be profitable.

This sounds innocuous but pls think abt it for a sec

7/11

If we don't take a chance, we won't get hurt, but on the other hand, we'll never know what could have been.

On top of that, if we don't take risk after risk, by making trade after trade, we will never sharpen our trading skills, and we will never become a winning trader.

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So when we face risks and possible losses, it’s wise to not despair about it.

Let me leave this thread with these three quotes –

1. A Ship in Harbor Is Safe, But that Is Not What Ships Are Built For – John Shedd

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2. People who look for easy money invariable pay for the privilege of proving conclusively that it cannot be found on this earth - Jesse Livermore

Easy come, easy go ■

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3. Even though most ppl think they are trying to succeed, they are simply going through the motions. The last thing in the world they want is to get off the familiar treadmill & actually get somewhere - Chin-Ning Chu author of "Thick Face, Black Heart"

Happy trading ■!!