



Brainy's Articles on Share Trading

Position sizing

Article No:
ST-4400
page 1 of 4
25 Feb 2009

This article
is NOT free*

Introduction

When setting out on a journey of share trading (or other derivatives like CFDs), two different people could use very similar trading strategies, but end up with one person make good profits, and the other making significant losses. This can happen if the “money management” is sloppy, or unplanned, or haphazard.

This article in Brainy's series on Share Trading (number ST-4400) provides information on just one aspect of money management — position sizing. This is basically the number of shares that you will purchase (the parcel size). This article focuses on trading in shares. It does not specifically consider derivatives like CFDs, nor short selling. These should be covered in another of Brainy's articles in the near future. In the meantime, it is useful to understand the information here in order to understand the total concept, and its application to share trading.

The overview section below talks about the relevance and importance of position sizing. The following sections address it in more detail. To support this topic there is a position size calculator available (in an Excel spreadsheet, or an OpenOffice spreadsheet). And there is information below that explains how to use the calculator.

Overview

When you buy shares (or derivatives like CFDs), you need to decide how much money to invest in any one position. That is, if you have \$1,000 to invest, should you invest all \$1,000? Or should you invest a smaller amount? How can you work out the optimum amount to invest? Or perhaps, why bother to work out the optimum amount — what difference does it make?

Consider the following questions regarding share trading (or other derivatives):

1. **Assumption:** Let's assume that you have only \$1,000 of capital that you could afford to lose. This could be workable for trading CFDs; but for share investing you probably need more like \$5,000 to \$10,000 as an absolute minimum. If you wanted to live off the profits of trading, then you might need something like \$250,000 capital.
2. **Question:** When you trade, would you be happy to risk perhaps just 2% of your total capital on any one trade? Note that 2% of \$1,000 is only \$20, so you could afford to have quite a few consecutive losses before your capital runs out.
3. **Question:** Would you like to take maximum advantage of the available capital, and make it work as hard as possible for you?
4. **Question:** Would you like to utilise the maximum amount of that 2% of at-risk capital?

If you answered yes to these questions, then you do need to consider the optimum amount of capital to invest in each position. So you might end up investing, say, \$1100 in one position, and \$900 in another. The important point here is that by actually risking the maximum amount that you can risk (ie. say 2% of capital), then you are taking maximum advantage of favourable price movements to maximise profits.

This article talks in more detail about how to work all this out. And it shows you a very quick, easy and simple way to work this out using the available Position Size Calculator worksheet. A quick view of what the calculator looks like is included in this article on page 2 below. Take a quick look at it now.

About the calculator

The Position Size Calculator was prepared using Open Office Calc, and saved as an OpenOffice ods file. It has also been saved as a Microsoft Excel xls file because a large number of people use this.

You can save the calculator file to your local computer, and have it open at all times when consider a trade. Entry initial information in the yellow cells, and stock-specific information in the green cells. The worksheet is “protected” (without a password), to prevent accidental changes of formulas.