

WINNING TRADES  
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# Forex JOURNAL

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**IN THIS ISSUE:** FOREX-RISK ANALYSES AND PIP PRODUCTION, ELLIOTT WAVE & WYCKOFF CANDLE VOLUME ANALYSIS, MONEY MANAGEMENT FOR MOVING AVERAGE FOREX STRATEGIES, AND USING MULTIPLE TIMEFRAMES IN YOUR ANALYSIS...

# Forex Risk Analyses and Pip Production

**Trading foreign currency pairs is much different than trading equities or futures for many reasons. Ron Schelling discusses how to focus attention on money management to enjoy long-term success by starting with low leverage Forex trades.**

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any new Forex traders concentrate too much of their time on technical analyses and all kinds of new trading instruments, including automated trading. Meanwhile, they forget the most important subject – money management.

It is important to have better knowledge of leverage, contract value, pip production, daily risk amount etc. In Forex trading, a 'pip' – also called a point, is the smallest price increment a currency can trade and 'pips produced' refers to the total net of profitable pips per month in our examples.

The term that many people get confused is 'leverage.' Here is how leverage works. A trader starting with \$10,000 in his

trading account can put on a currency position with an underlying value of more than \$10,000. Some brokerage firms allow traders to trade 100 to 1 leverage. That means a trader with a \$10,000 account could put on a long or short position with an underlying value of \$100,000. There are some brokerage firms who offer 400 to 1 leverage. But in the United States, most firms are forced to use a maximum 50 to 1 leverage.

In a U.S. dollar account for every \$10,000 in contract value, a pip move is fixed at \$1 in the EUR/USD, USD/CHF, AUD/USD and the NZD/USD. This means that a gain of 20 pips on a trade generates a profit of \$20 based on \$10,000. This is also known as a one mini-lot trade position.

The same trade results in a \$200 profit if the trader puts on a \$100,000 position or a full-sized lot trade. The great appeal of Forex trading is the ability to put on trades of large amounts instantly with less money.

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owever, this type of leverage proves to be a double-edged sword. When a trade works, it is a fast way to a high income. When a trade does not work, the risk of ruin can be real. Have a look at some examples.

Consider a trader with a U.S. dollar account with \$5,000 with a goal of \$2,000 in profits per month. How realistic is this goal? The answer depends upon the leverage used. Using 2 to 1 leverage, a trader would be putting on a \$10,000 position every trade. At this low-leverage level, the number of pips produced monthly would have to be 2,000 pips to achieve \$2,000 per month. This is delusional and leverage would need to be increased immediately after any drawdown to trade just the mini lot.

Let's change the scenario. Let's have the trader achieve 400 pips per month and step up the leverage to 3 to 1. This means the trader would need to put on an average trade of \$15,000 (a level of 1.5 mini-lots per trade).

It is strongly advised to use a 'pip production calculator,' which generates projected income based on various account sizes and leverage. (See Figure 1 below)

Let's examine a larger account size with smaller leverage and pip production of 350 pips per month. With \$20,000 in the account, using leverage of 5 to 1, the trader will be trading in ticket sizes of \$100,000 or one big lot. His income will be \$3,500 per month. It is interesting to note that the production of 16.2 pips per day is entirely feasible. You can download the Pip Production Calculator from several Forex brokerage websites in order to test your strategy.

Achieving income goals is about leverage and account size. It is a precarious balancing act. The path to pip production is different for everyone because all traders have unique combinations of goals, means and ability. The best approach is an evolutionary one. Getting started in Forex trading begins with finding out what kind of pip producer you are, but your first 20 trades should be done at low leverage.

Maybe the best advice for news Forex traders is to test all those strategies – stops, pip production, targets and money management with a free demo account, which are available from most Forex brokerage firms. Demo account trading is also a good way to get familiar with the platform itself as far as order input etc.

In a second step, if you have for example a real \$10,000 account, the first 20 trades should use no leverage at all. This results in the ability to learn from mistakes and survive them.

Trading mini lots (\$10,000) with no leverage generates a \$1 per pip move. A 100-pip loss represents a 1% drawdown.

The same pip move with the typical \$100,000 per trade, in the same account, would mean a \$1,000 loss (10%) for one trade.

Once a trading style is developed and tested, the trader can go about setting the appropriate amount of leverage to use. The best way to achieve long-term success is to start with low leverage and test your skills. **TFJ**

Ron Schelling is an independent trader in The Netherlands with over 27 years of experience in Forex, futures and arbitrage trading. He can be reached at [www.2hedge.com](http://www.2hedge.com)

### PIP Production Calculator

<b>Account Size</b>	<b>Fixed</b> € 50.000,00	<b>Beginning Balance</b>	<b>Performance</b> € 50.000,00
<b>Leverage</b>	2,0	<b>Ending Balance</b>	€ 75.000,00
<b>Pips per Day</b>	10	<b>Return</b>	50%
<b>Pips per Week</b>	50		
<b>Pips per Month</b>	200		

  

n	Acct Size	Leverage	Pips/Month	Monthly €	LotSize	Trade / Pip	€ / Day	€ / Week
1	€ 50.000	2,0	200	€ 2.000	€ 100.000	€ 10	€ 100	€ 500
2	€ 52.000	2,0	200	€ 2.000	€ 100.000	€ 10	€ 100	€ 500
3	€ 54.000	2,0	200	€ 2.200	€ 110.000	€ 11	€ 110	€ 550
4	€ 56.200	2,0	200	€ 2.200	€ 110.000	€ 11	€ 110	€ 550
5	€ 58.400	2,0	200	€ 2.400	€ 120.000	€ 12	€ 120	€ 600
6	€ 60.800	2,0	200	€ 2.400	€ 120.000	€ 12	€ 120	€ 600
7	€ 63.200	2,0	200	€ 2.600	€ 130.000	€ 13	€ 130	€ 650
8	€ 65.800	2,0	200	€ 2.600	€ 130.000	€ 13	€ 130	€ 650
9	€ 68.400	2,0	200	€ 2.800	€ 140.000	€ 14	€ 140	€ 700
10	€ 71.200	2,0	200	€ 2.800	€ 140.000	€ 14	€ 140	€ 700
11	€ 74.000	2,0	200	€ 3.000	€ 150.000	€ 15	€ 150	€ 750
12	€ 77.000	2,0	200	€ 3.000	€ 150.000	€ 15	€ 150	€ 750

For example, consider a different scenario where the trader starts with the same \$5,000 per month but also reinvests \$500 of profits per month in trading. Using the same 3:1 leverage and a 400-pip production level, the result is \$875 per month in expected income. By reinvesting \$500 per month for three months in a row, if expected profits are met, by the fourth month the trader has accumulated an additional \$1,000 per month he can reinvest, if expected profits are met.

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