

# Risk vs Reward

In order to be successful at trading any instrument you need to understand risk and reward.

If someone told you they would give you \$10.00 to light your hand on fire you would tell them to take a hike, but if someone said they would give you 5 million to light your hand on fire you might start saying things like...

- 1.) How long do I have to keep it on fire?
- 2.) Can I stand by a pool or river to extinguish it immediately?

**The difference in your response has everything to do with the reward vs the risk.**

Once I bought a tazer gun and really wanted to see how it worked. I had a friend who was in need of cash and I said I'll give you everything in my wallet if you let me taze you.

He said how much is in your wallet, I looked and I had \$80.00.

He jumped on it, I tazed him, and he hit the ground like bird that smacked a windshield at 75 MPH.

**You see he needed food, and \$80 was worth a lot more to him than severe discomfort.**

**\$80 meant a full tummy, and getting knocked off your feet by 50K volts was worth a full tummy to him...**

When it comes to trading if you don't know with a degree of certainty that a certain % of reward is possible or likely, you will fail at trading, it's just a matter of time.

If you trade options you must have a method to calculate the reward potential relative to the risk.

The stock part is easy, the hard part is going to the option chain and identifying a fairly priced high reward potential option in the chain.

A good rule of thumb for me being conservative and using some logic with regard to my win / loss ratio is a 3 to 1.

If I'm going to risk \$500 then \$1500 needs to be a relatively easy reach.

If not then **it's not worth the risk and I move on.**

I will sometimes take profits at less than a 3 to 1 but that is only when circumstance require that I do so.

This is usually related to a drastic change in market sentiment or technical considerations that have invalidated the reason behind the trade.

If you make risk and reward a priority consideration in your trading, you will have mastered the first step in becoming a very, very, very successful trader.

This document is for educational purposes only. Please consult your stock broker, tax attorney, accountant, mom and dad, and any one else that has anything to do with your life before you ever consider applying it to your trading.

This is not advice on how to trade. Please be aware that trading involves risk, and you can lose all of your money, and you are 100% responsible for any loss you may incur.

<http://www.tradingdomination.com>