

## How to Trade Like a Business

### Lesson # 7

#### Return on Investment

In previous lessons, we learned how to create a Profit Center structure designed to organize our trading results, similar to the techniques of successful businesses. We also took a look at the Drawdown Report which can be created from the trading results we entered into our Profit Centers.

In this lesson, we take a look at another important report, the Return on Investment (ROI). The ROI report measures the percentage profit or loss of trading capital on a profitable or unprofitable trade. If you have \$10,000 in Trading Capital, and you lose \$300 on a trade, you have lost 3% of trading capital.

There are many complex formulas and techniques for portfolio management and money management, but to make life as simple as possible, you should make every attempt to never lose more than 1% of trading capital on any one trade. If you consistently lose a high percentage of trading capital on every trade, such a 3% or 5%, you will lose a significant percentage of trading capital when you hit that inevitable bad series of losing trades such as 10 losers out of 12, or 14 losers out of 18.

The ROI report should be created so that profitable and unprofitable trades are listed separately on the report for ease of viewing. Each profitable trade and each unprofitable trade should display the % of trading capital gained or lost.

In addition, the report should display a Running Average of the percentages. For example, if the first three unprofitable trades had a 2%, 1% and 3% loss as a percent of trading capital, then the Running Average after the third trade would equal :

$$(2\% + 1\% + 3\%) / 3 \text{ trades which equals } (6\%) / 3 = 2\%$$

You would always like to see this Running Average never worse (more negative) than 1%.

Use the same technique for profitable trades. For example, if the first three profitable trades had 4%, 2%, and 3% profit as a percent of trading capital, then the Running Average after the third trade would equal:

$$(4\% + 2\% + 3\%) / 3 \text{ trades which equals } (9\%) / 3 = 3\%$$

You would obviously like to see this Running Average as high as possible and increasing.

Now divide the Running Average of profitable trades by the Running Average of unprofitable trades to obtain the Running Average Ratio, which, in our example, after the third trade equals :

$$3\% / 2\% = 1.50$$

You would like to see the Running Average Ratio as high as possible and increasing, indicating that you are making a higher percentage profit on profitable trades than on unprofitable trades.

These simple calculations are the mainstay of a very effective money management methodology. The percentage of trading capital that you make or lose on profitable and unprofitable trades will eventually determine your eventual success or failure in the trading game.

The goal of trading is to play a positive expectation game and risk a small percentage of capital on each trade, and get into the long run - similar to a casino. If you risk a high percentage of capital and play a negative expectation game, you will go broke very rapidly.

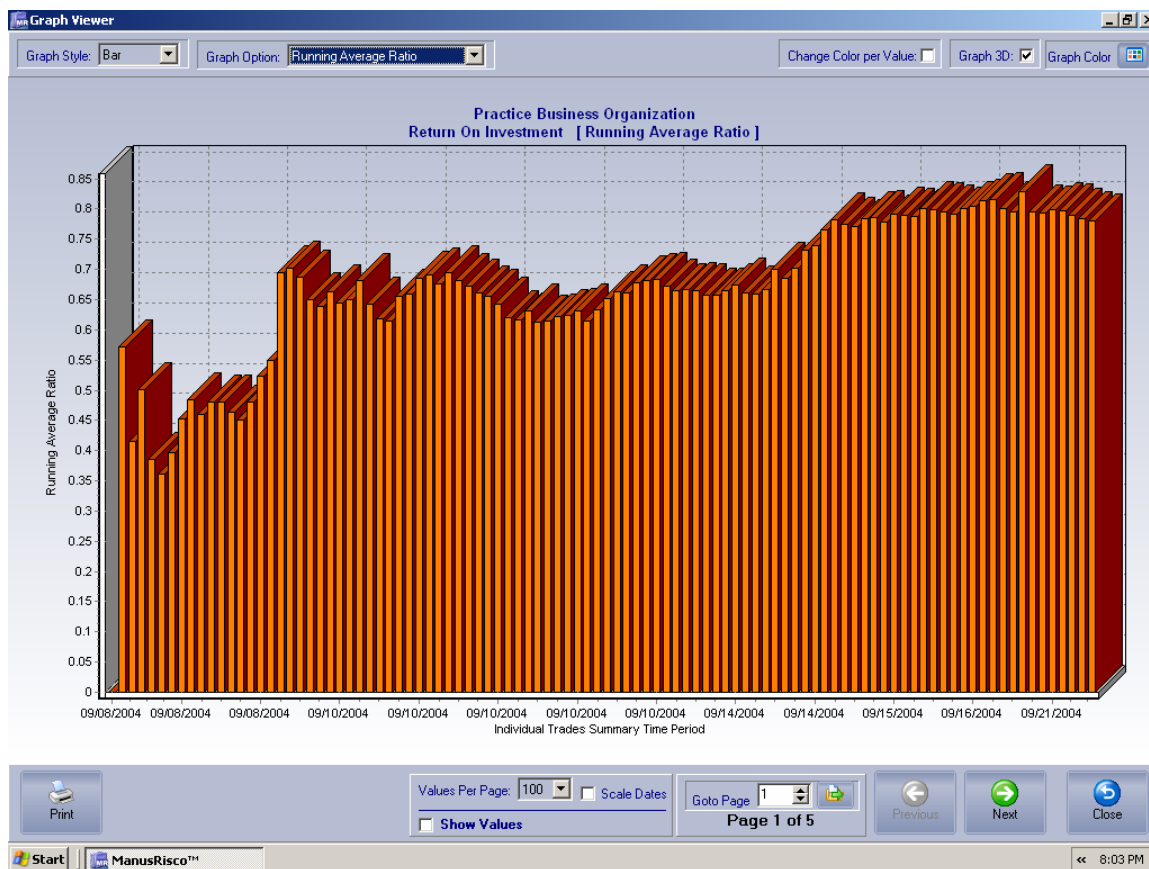
Now comes the most important part, which is to create graphs of all the above statistics. Graphs not only reveal the value of the statistic, but also the trend.

If the Running Average of unprofitable trades is consistently worse than 1% and becoming more negative, you will have to examine your stop loss strategy to determine if your stops are too large relative to the trading capital. You could be in for big trouble when that long series of losing trades occurs.

If your Running Average of profitable trades is decreasing, you will have to examine your trading strategy to determine if you are taking too small profits and not letting profits run.

If the graph of the Running Average Ratio is decreasing, then you have the worst of both situations: the percentage of trading capital you are making on profitable trades is decreasing relative to the percentage of trading capital you are losing on unprofitable trades. You need to examine both your profit objective and stop loss strategy to determine the problem with your trading methodology, and take steps to fix it.

The first screenshot displays the graph of the Running Average Ratio. The Ratio is increasing, which is good; but ideally, the Ratio should also be above 1.0, which it is not.



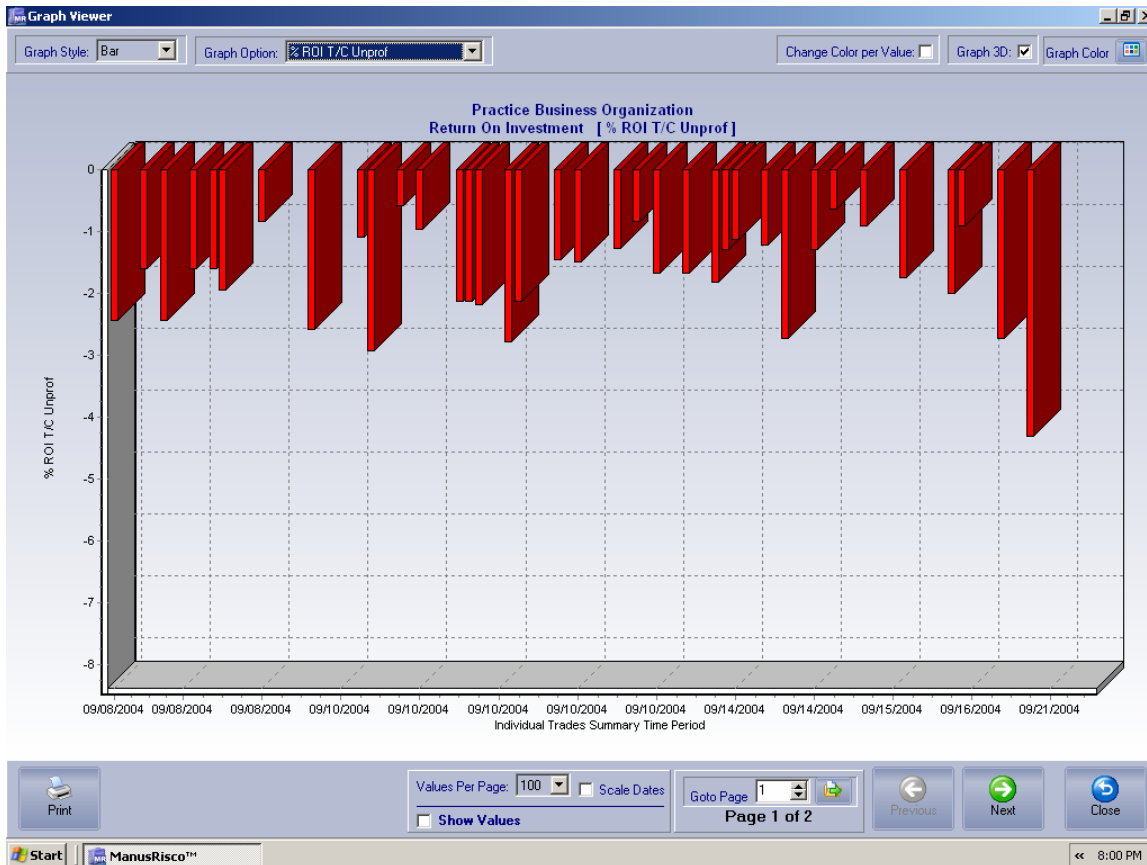
The second screen shot displays the percentage of Trading Capital lost on an unprofitable trade. You would not like to see this percentage worse than 1%. Since most of the percentages on the graph are worse than 1%, this would be a high risk and dangerous situation.

Recommended by Joe Ross & Trading Educators Inc.

<http://www.tradingeducators.com>

More lessons by ManusRisco available in PDF-Format at

<http://www.tradingeducators.com/resources/manusrisco.htm>



Properly designed Drawdown (discussed in Lesson #6) and ROI reports are an absolute requirement if a trader desires to achieve long term profitability playing the trading game.

You also need to be an efficient trader, which is measured by the PTR and UTR. What are the PTR and UTR? Well, we will have to wait for the next lesson to find out.

Tom D'Angelo  
CEO  
ManusRisco Inc



## **Trading Method for E-mini S&P**

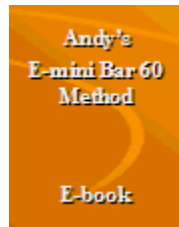
Dear Trader,

Andy Jordan, our in-house trader, completed a long period of testing and trading an E-mini S&P 500 method. The results of the testing were more than satisfactory.

If you are looking for a potentially profitable way to day trade the E-mini S&P, we believe that we have come up with a way to do it consistently over a long period of time.

In over a year of trading, the parameters of the method have never had to be changed. Profits are better than 2 to 1, drawdowns are very small, losses even smaller, and profits steady and more than adequate.

We would like to tell you more about this method, called "Andy's E-mini Bar."



Please follow the link below to learn about this simple, but very effective trading method. It is easy to understand and execute.

**[http://tradingeducators.com/books/andys\\_emi\\_bar/emi.htm](http://tradingeducators.com/books/andys_emi_bar/emi.htm)**

Happy trading,

Joe Ross