

Simulated Trading Tool User Manual

Thanks for downloading the Trade Simulator Tool from PowerOptions. This Tool is meant to be a companion to these RadioActive Trading Products:

- **The Sketch:** download for free at <http://www.poweropt.com/sketch.asp>
- **Trade Simulator Tool:** http://www.poweropt.com/PowerOptions_Simulated_Trading.xls
- **Live Webinars:** Schedule at <http://www.poweropt.com/webinars.asp>
- **The Blueprint:** Available at the Nov. 4th webinar

The object of this program is to help investors understand the importance of the little known principle of "Optimum Position Sizing".

The program's purpose is NOT to predict or project what YOU will earn over your next 100 trades... PLEASE don't get that idea... but what it will do is demonstrate the effect of money management as it relates to trading.

We all already practice money management in our daily living. Most of us that have children have been asked, "Can I get that toy, Daddy?"... "May I have dancing lessons, Mommy?"

In my experience, parents answer that question THREE different ways. If they answer "Yes" or "No" it's usually because they already know the answer to the third... "How much?"

Yes, no... how much. How much to put on the line at one time is the question. Deciding HOW MUCH of one's investment nest egg to put AT RISK at a time is crucial. Here's why:

Say you have a shoo-in. A no-brainer. A stock that plain just HAS to go up. You bet your whole stash because you know that the more you put in, the bigger your payout in case you're right.

But there's a problem. The FDA refuses to approve the new drug... the earnings came out and surprised everyone to the bad... or Asian markets flipped out overnight and there's a 700 point sympathy drop in the Dow... or... fill in the blank. If you expose too much to the ravages of the market, picking the wrong stock or the wrong TIME to get in... can get you in serious trouble.

On the other hand, what if you DO pick right? Your investment size makes a difference there too. Say you go to your spouse and say, "Honey, I just made 100% on one of my trades in the stock market!". That's great news, right? Then comes the logical next question...

"Honey, that's great! HOW MUCH did you put in?" If all you committed out of your entire savings to that one trade was \$10 to buy 100 shares of a penny stock. Your round trip commissions would cost more than your win earned! So risking too little can actually be a detriment. This is an extreme example but folks often do over-trade their accounts, without betting the OPTIMUM amount.

The object of Optimum Position Sizing is to bet the ideal amount in each trade; not so much that a loss really hurts, and not so little that a gain doesn't matter. With proper position sizing, your winning trades bring in healthy gains, and even losing trades don't have to be a problem... if they are controlled and balanced with enough winning trades.

As we'll see with this calculator, knowing how much to put AT RISK is crucial. The Trading Simulation Tool is designed to let YOU sell YOURSELF on the idea of good money management. Play around with it, try a lot of different scenarios. The random run of winners and losers, over a period of 100 trades, will provide all the evidence you need to conclude that money management... position sizing... is the most important factor of trading. Regardless of WHAT issues we are trading, it's the answer to the age-old question: Size matters.

Here are some instructions for using the Trading Simulator Tool...

1) When you run the calculator, a series of 100 trades will be made with a randomly generated series of wins and losses. After each trade the dollar value of the account is calculated and the total posted after the 100 trades were made.

2) Default parameters are provided to start the process. However, here are some areas that you'll want to fiddle with and see what kinds of results you can expect from consistently trading a certain way. Here they are:

Target – This is the % return that you get for a winning trade. Click in the box and set it to whatever number you like .

Loss Limit – The maximum loss if you lose on the trade. Click in this box too... it's in the changes that you make to THIS box that things get interesting.

Probability of loss – This is expressed as a fraction. Start with .50, or 50/50 chances, and adjust from there. If you set it at .50, you will have anywhere from 40 to 60 wins each time you run the simulation, in a random sequence.

Starting Amount – The amount of capital in your account at the beginning. I like to use \$10,000 but you can adjust it to the actual amount that you trade after doing the exercises

Commissions – Both the stock and option commissions can be changed. The number of option trades used for each investment can also be changed. Just click in the box. The default setting is that it takes two stock and four option trades to get in and out of a typical RPM trade according to **The Sketch**.

3) After filling in the blue area with your desired conditions, press F9. The area in yellow contains the summary of results for 100 simulated trades. It shows the number of wins and losses generated from the random toss process. Displayed are the highest and the lowest values reached during the 100 trades and an ending value. If you like, scroll down and see the results for each iteration from the 1st trade to the 100th.

Time saver! Each time F9 is clicked, a new set of 100 trades are calculated with the results displayed.

Now for some Exercises.

- 1) Try plugging in 10% to both the Target and the Loss Limit. Run the simulation 10-12 times (remember to press the F9 key... it's faster). You'll probably be horrified at what you see... after 100 trades, depending on your luck you'll either be in debt... or have lost most of your capital... or at best be ahead a little but nowhere NEAR what you think you should be getting for having traded 100 times.
- 2) Next, SKEW the Risk vs. Reward... by changing the gains Target to 15%. This will leave a skew of 5%: If you LOSE, it's 10% but if you WIN it's a 15% gain. Run the simulation 10-12 times again as well. You'll likely be pleased with this one... but remember, it's not the gain target that you can control in any trade. It's the loss limit.
- 3) Finally, skew the Risk vs. Reward by the same amount: 5%. Only this time, instead of increasing the gain target, DECREASE it to a believable, conservative amount... say 8%. At the same time, lower the risk all the way down to 3%. Run this 3% vs. 8% simulation 10-12 times

When you do the above exercises, keep a log of the results. Every once in a while, scroll down the list and see the run of the trades... you may see that at times the result goes down to BELOW your starting capital. But in each simulation, you'll very likely end up with a number that's GOOD when you skew the risk, and a bad or not-so-good result when you don't.

Here's the conclusion that I hope you come to: The one thing that you absolutely CAN control is (thankfully) the key to your success, given a long enough horizon. You can't control whether a stock goes up or down, but you CAN control your exit even through an opening gap with the principles contained in **The Sketch**.

It is important to use the proper investment amount for each trade. An investor needs to make it the highest priority to survive and have money left for the next trade. One must be able survive several losing trades in a row and still have investment funds remaining. And, of course the next priority should be to bet enough to make a real difference in case you're right.

But many investors reach too high for returns or the amount they invest on each trade to their own peril. Try these exercises with modest gains... And see how limiting the DOWNSIDE risk.. the thing you CAN control with the RPM setup... makes a powerful difference. Here's a lesson too costly to allow EXPERIENCE and not the Trading Simulator Tool teach you... it is ESPECIALLY dangerous when an investor has several successful investments in a row because it creates a sense of overconfidence and therefore the tendency to over-trade.

Pass this Calculator around to your investing buddies! If they don't have a copy of **The Sketch**, send them this link as well. Then consider coming to any of our live webinars for more training. Check out how this principle has worked with real-time, real- money trades. Then pick up your own copy of **The Blueprint** and get on the road to success with trading.

Here are those links:

- **The Sketch:** <http://www.poweropt.com/sketch.asp>
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Happy Trading!

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