Stop loss setting, one of the most crucial aspects of money management.

The most important rule to remember is to set a stop loss of each order to max. 3% of trading capital. Losses, that should be considered as normal costs of business activity, are part of trader's routine. Using the Stop Loss (SL) ensures that trader has enough capital to continue, even after a long losing streak.

In Basics-section reader has been introduced to terms leverage, margin and margin call. I will now give a brief example of how the SL is connected to those. In the beginning of my trading career I have read from various sources how dangerous high leverage can be. Soon I understood the fact that no matter the leverage, you should use only fraction of it. In other words, never taking big risks and using the SL setting correctly. Basically, high leverages (from 1:50 to astronomical 1:500) just open a possibility to take destructive risk, with small capital and nonexistent money management. It is very dangerous for uneducated beginner, aiming to multiply the capital in one trade. The ability to take unnecessary risks reduces with lower leverages.

Let's assume that you have a smallest possible order size of 0.01 lot (volume is then 1000), €-account and EUR/USD pair to trade on. Calculation for 1:30 leverage case, where currency price on €-account is 1:

(Currency price × volume) / leverage = Margin

(1 × 1000) / 30 = 33.33€ (rounded to 33€ for clarity)

And so, to open 0.01 lot order you need to have only 33€ on your account. With higher leverage you need even less. Therefore, with small capital you could open oversize order and, potentially, lose all your funds during one losing trade and only a few price ticks. That is the opposite to correct money management! You could calculate margin requirements for different lot size, in order to fully understand the margin aspect.

When the order gets far on the losing side, brokers gives a Margin Call (a request to transfer more funds to trading account). If the loss reaches certain value, and no addition funds are transferred, the position is closed automatically. An example of broker's trading conditions:

Margin call 100%, Stop out 50%

For example, 500€ trading account with 1:30 leverage. You open a 0.1 lot (10'000) position and 333€ margin is used. Margin call would come when there is 333€ × 100% = 333€ left in your account, meaning that the trade is losing 167€. The order will be closed automatically by broker (Stop out) when there is only 333€ × 50% = 167€ left. In this case, the loss of the trade is already 500€ - 167€ = 333€. Loss to capital ratio is huge 67% (333€ / 500€). Compare this to proper risk management value of 3%! For 500€ account, correct risk per trade is 500€ x 3% = 15€, so big leverage and margin call are irrelevant in proper trading.

The moral of the story is to always consider the Stop Loss limit when planning a trade. Not matter the capital size (100 or 100'000€) or the margin, the 3% risk rule is the most relevant! When you have mastered the basics and selected own trading strategy, you could use a handy lot-size calculator for that 3% risk. ”Stop Loss in Pips” value is defined by your strategy setup, but for testing purpose you could enter 25 pips. For 500€ account and 3% risk, 25 pip SL means ~0.07 lot size. 1:30 leverage is more than enough for that.