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## THE TEN PERCENT RULE

CAPITAL MANAGEMENT & STOP LOSS STRATEGIES FOR THE ART OF TRADING PORTFOLIO

## The 10 Percent Rule

### Capital Management & Stop Loss Strategies for the Art of Trading Portfolio

I frequently get questions in regards to the way I manage the positions within the Art of Trading swing trading portfolio. So, I wanted to take the time to create a document that highlights my strategy for the portfolio, relative to the current market conditions (2020 – Q1 2021). This guide will highlight how I size my trades, some visuals that highlight my thinking, and stop loss strategies that you can use while trading the Art of Trading swing trades.

This is how we're going to break this document down:

- 1. The 10 Percent Rule**

In this section I will talk about sizing each trade with consistency and some visual representation on how this size can swing capital within the account.

- 2. Stop loss strategies for the Art of Trading portfolio**

In this section we will review stop loss strategies in which you could consider while trading the Art of Trading swing trading alerts.

*To overview the data contained within the document in a quick and efficient way, I will summarize my thoughts here first.*

**Position Sizing:** I size each one of my trades within the Art of Trading swing trading portfolio at 10% capital allocation per trade. To put it into the simplest of terms, if you're trading a \$100k sized account each trade initiated would be sized at \$10k. In my opinion this offers a nice mix of flexibility, the ability to create a portfolio, the ability to scale in and out of the market, trading with responsible size, and the ability too withstand the ups and downs of the market without emotions taking over the trade.

***Consistent position size is a major factor in producing consistent results!***

**Stop Losses:** Through 2020 and into this year I made the decision to take a much more "relaxed" approach in the way I handled stop losses in the account. As we started taking a **portfolio approach** in conjunction with the **Ten Percent Rule**, I decided to take off the stops in my Art of Trading swing trading account. *Personally, I don't actually recommend doing this*, but to best copy the results and returns of the account, this plays a key roll. A key factor to this major decision was simply because of the size in which the Art of Trading community grew into. I started noticing a phenomenon in late 2018 and well into 2019 with the "ideal" stop loss areas I was attaching to the trades. Many times, we had perfectly good positions sell off right into the stop loss area that were put on by the Art of Trading group (sometimes right on the penny) only for the position to reverse back into the previous trading levels within very short periods of time (Sometimes as quickly as 20 – 30 minutes). I believe the group was creating enough volume for these stop loss orders to be targeted by market makers, hindering the potential performance of the account during the 2018 – 2019 trading years. **With the new approach in 2020 the results solidified my thoughts on this. We traded with the new strategy and returned 107%!**

### The 10 Percent Rule:

Basically, the “10 Percent Rule” is just how it sounds. I position each one of my trades in the Art of Trading swing account at 10% capital allocation per trade. To put it into the simplest of terms, if you’re trading a \$100k sized account each trade initiated would be sized at \$10k.

*Let’s look at how this size can fluctuate capital within the account during a drawdown or pullback phase:*

POSITION SIZE 10% (\$)	DRAWDOWN %	POSITION CAPITAL DRAWDOWN \$	DRAWDOWN OF 100K %
\$10,000	1%	\$100	0.1%
\$10,000	5%	\$500	0.5%
\$10,000	10%	\$1000	1.0%
\$10,000	20%	\$2000	2.0%
\$10,000	25%	\$2500	2.5%

As you can see from the above chart **even with a 25% drawdown on a single position**, positioned at 10% size, **the draw down on the total capital (100K) On the account is 2.5%**. A single position within your trading account should never solely jeopardize the account as a whole. In my opinion 10% sized trades offer enough size to help an account grow but not so much that a single trade can make or break the performance of the account in a **portfolio strategy scenario**.

Now let’s take the 10% rule strategy and apply it to our current holdings within our portfolio.

STOCK SYMBOL	ENTRY PRICE	SHARES HELD	P & L OPEN	% MOVE ON TOTAL CAPITAL (\$100K)
\$SOLO	\$7.25	1379	\$413.70	0.41%
\$COTY	\$7.00	1428	(\$142.80)	(0.14%)
\$DKNG	\$54.00	185	(\$55.50)	(0.06%)
\$OSTK (1/2 SIZED)	\$81.45	61	(\$1337.73)	(1.33%)
\$PEIX	\$6.55	1526	\$564.62	0.56%
\$ACB (1/2 SIZED)	\$11.25	444	\$350.76	0.35%
\$PLTR	\$25.97	385	(\$127.05)	(0.13%)
\$FUBO	\$37.00	270	(\$1314.90)	(1.31%)
\$VERU	\$8.70	1149	\$218.31	0.22%
\$XPEV	\$43.00	232	\$1118.24	1.12%
\$BTBT	\$16.80	595	(\$83.30)	(0.08%)
<b>TOTALS</b>	<b>10 FULL POSITIONS</b>	<b>100% INVESTED</b>	<b>(\$395.56)</b>	<b>(.39%)</b>

As you can see with our current portfolio holdings, not a single position can jeopardize the account. Occasionally you’ll get an outlying position such as \$OSTK with a larger than average draw down. This can happen periodically, but it generally made up for by other positions that outperform. **Selling strength on positions is what I generally try to do based on the technical characteristics of the chart and the general market conditions.** In hindsight \$FUBO and \$BTBT could have been great bookable gains into strength, but looking at the technical aspects of the chart at the time, it didn’t warrant selling that strength. **This is where you as a trader can make up a rule set that may or may not warrant a sell.**

The **Power Earnings Gap** strategy helps give us our edge within the portfolio. Following the leading stocks that are in strong uptrends with strong earnings helps us create a strong portfolio, which in theory, should outperform the market with a relaxed approach. As themes in the market come and go, I try to identify these themes, trade them, and benefit from them. An example of where I applied the theme strategy was on the highly shorted “open the economy” stocks that we traded with great success last year. Another key factor to this approach is following the general trend of the market. ***If the broad market continues to trend upwards, I tend to stay bullish in my approach. Don't fight the trend and don't fight the FED as they say.***

Now, ***lets test the Ten Percent Rule*** against a “[Black Swan](#)” event. Such as the Covid-19 Sell off we seen in early 2020. We will look at 3 scenarios, a 10% market draw down, a 15% market draw down, and a 20% market drawdown. The average holdings within the portfolio usually sits between 5 – 7 at a time. So, **for the scenario we will assume a total of 6 positions are being held equally across the market.**

#### **“Black Swan” Event Examples:**

STOCK SYMBOL	ENTRY PRICE	DRAWDOWN %	P & L OPEN	% MOVE ON TOTAL CAPITAL (\$100k)
\$QQQ	315.00	10%	(\$1000.00)	(1.00%)
\$SPY	378.00	10%	(\$1000.00)	(1.00%)
\$XLF	31.00	10%	(\$1000.00)	(1.00%)
\$DIA	309.00	10%	(\$1000.00)	(1.00%)
\$IWM	212.00	10%	(\$1000.00)	(1.00%)
\$SMH	240.00	10%	(\$1000.00)	(1.00%)
CASH 40%	N/A	0%	\$0.00	0%
TOTALS	6 POSITIONS / 40% CASH	n/a	(\$6000.00)	(6%) Move on 100k

**On 6 open positions - (Portfolio Average) on a 10% down move in the market** holding 40% cash the portfolio loses 6% against the markets 10% loss. The cash in the portfolio provides protection.

**If you plot the same data with a 15% down move in the market** with the same positions ***the portfolio will move 9% down*** against ***the markets 15% loss***. Again, cash provides the protection and an opportunity to buy potential reversal positions.

**If you plot the same data with a 20% down move in the market** with the same positions ***the portfolio will move 12% down*** against ***the markets 20% loss***. Again, cash provides the protection and an opportunity to buy potential reversal positions.

With this portfolio positioning strategy, you can see how it can become easier to remove the emotion from the trade. The key takeaways from this approach should be:

- Always trade with consistent position size.
- No single position size should ever potentially jeopardize the portfolio.
- Your position size should never make you feel emotional about the trade.
- Cash is a position in uncertain times.
- Less is more in a choppy trading environment.

## Stop Losses:

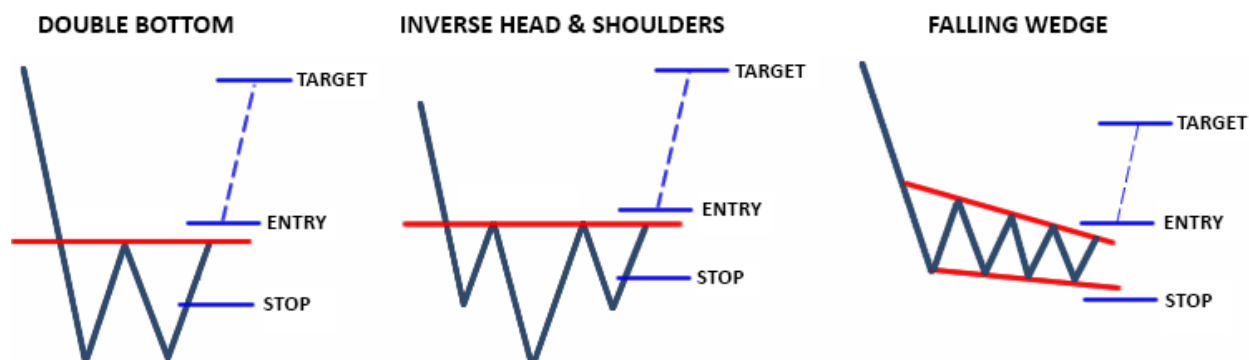
With each entry officially alerted on the Art of Trading private twitter feed a chart is provided with the entry highlighting the trading pattern. Generally, at the point in which the pattern fails is the point in which you place your stop loss. (Its good practice to place it slightly below the failure point as this will prevent stop outs on false moves down – *shakeouts in the market within the first 1-2 hours of the trading day*)

Here are some simple graphics of the chart patterns that we trade most. With an ideal stop area noted on each:

## Continuation Patterns:



## Reversal Patterns:



**Hammer candle reversal patterns on a daily time frame:** The stop area goes slightly below the low on the Hammer candle.

**Holy Grail Setups:** The stop goes slightly below the reversal “Holy Grail” candle on the daily time frame.

*With these basic chart graphics, you can use these “stop” areas as a guide towards the trades we put on in The Art of Trading portfolio. If you are unsure if an ideal area, just ask. Either on the private Art of Trading feed or through Email.*

Now let's look at a recent chart we traded \$XPEV, and plot out ideal stop areas.



Annotated on the chart (Zoom to see clearly) Is the ideal entry area \$44 and an Ideal stop loss area \$36.00. If you use our \$100K – 10 percent rule – swing trading account. In this example you would have bought 227 shares. Your risk is \$8 (\$44 entry *minus* \$36 stop loss = **\$8 risk**) **227 shares X 8 = \$1816 downside**. Your total risk on the \$100K total capital is 1.8%.

I hope this clears up some of the questions I get about the strategy within the account and how I size and trade in and out of the market. I plan on to continue to trade the official Art of Trading swing trading account in this manner. It has proven successful. Until we see a major shift in the trend or a major change in market character my strategy will stand.

Happy trading,

Art of Trading