

## TRANSCRIPT

# Trading Basics Week 4: Managing risk and creating an exit strategy

*Presenters:*

*Nicholas Delisse, CFA®, Trading Strategy Desk®, Fidelity Investments*

*Peter Janssen, CFP®, Trading Strategy Desk®, Fidelity Investments*

**NICHOLAS DELISSE:** Hello, and welcome back and everyone for our part 4 of our four-part series on trading basics. This week, we're going to be talking about managing risk in creating your exit strategy. We always get asked during the first three parts of this series about stop-loss orders and how do I leverage stop-loss orders. How do I use stop-loss orders. Well, this is the session that we actually take a deeper dive into those particular orders.

We'll talk about stop-loss trailing, stop-loss, stop-limit orders. And so I strongly encourage you to get the most out of this particular session that you can. Now, that said, we are going to kick off a little bit about having a conversation on managing risk, dealing with position sizing, planning your exits, having an exit strategy because one thing that we talk about is that what you enter at might not be such a big deal, where you exit needs to be a critical part of your trade planning process.

When do you get out? When do you cut the loss? Do you take a 1% loss, a 5% loss, a 10% loss, a couple dollar loss? That's going to be more important than looking at where you might have those gains. From there, that conversation about managing risk, then we're going to jump into those conditional orders, stop-loss orders.

And we'll talk about some bracket orders as well, as well as different ways you can monitor your positions, employ a few technical analysis techniques to get started. That said, Peter, why don't you introduce to us a couple of those important key concepts as it regards to risk management.

**PETER JANSSEN:** Yeah, I'd be happy to, Nick. And I think we talk about introducing these concepts. Truthfully, we did speak about these in the first week of our session here as well. So it's a little bit of a revisitation with these things to consider. And hopefully, some of this is beginning to click and make sense as we've gone through all of these different weeks so far. But to really be able to put a bow on lots of these concepts here, we have these bullet points up in front for everyone to take a look at.

I won't necessarily just read off every single word, but we had talked a lot throughout this month about being able to look for what are referred to as risk adjusted returns, which means that in order for us to profit or have returns, we're going to have to take risk in order to do so.

But we want that risk to be appropriate. We want it to be spread out, not necessarily putting all our eggs in one basket, which is where when we're taking a look at diversifying among those different market caps or the different sectors, what companies do, how can we classify

them. Where are they located from a geography standpoint? Are they international companies? Are they just domestic here in the United States?

There's a lot of different ways to consider, as well as that style box, which we had talked about, that you can look at on your own web page as well for whether it's a growth company, whether it's a small cap, large cap value, this, that, or the other.

So I think all of that ties into the fact that there are, I don't want to say endless, but there are ever-growing number of possibilities for investments to be made out there, which is why having also that position size or the concept of not having perhaps just one or two positions in your portfolio that can be very much so feast or famine, and I'm sure we've all heard of maybe someone who has made a fortune off that one single trade.

And kudos to them if that has worked out. But for every one of those stories that you hear about, there are countless others that did not turn out quite the same way, which is why being able to look for areas of opportunity while also managing risk and utilizing a position size that doesn't spread our portfolio too thin to where now we're having to keep track of hundreds and hundreds of different positions, which can be a very daunting task to keep track of all the news events, perhaps earnings cycles, whatever it might be.

But then also not being so concentrated that we only have a few positions in our portfolio where when the inevitability of if one of those does not perhaps work out, it could be very detrimental to our overall net worth and portfolio. So we want to be able to be investing and trading for years and years to come, which is why these are commonly accepted thoughts when you're building a portfolio overall.

We talk about having that exit strategy at the time of entering the trade. We'll look at different ways to use order types, perhaps, so that if there is a percentage price drop, or maybe if there are various areas of importance via what's called technical levels, we'll then maybe an order is actually going to trigger in place for you, which I'd say the benefit of, Nick, if nothing more is being able to take that mental angst or fatigue off of your plate and just know that you went into this opportunity knowing that you'd manage risk with a certain line in the sand.

And if that then is triggered, well, the trade is going to go ahead and execute, which is what I think can be tremendously helpful because it can be very emotional to try to close a position. Yes, at a gain, closing a position can be very, very exciting if you're closing it for a gain, but it can also be very, very detrimental to your psychology. If you're closing at a loss and you're clouding your judgment.

Now, we'll move on over to the next slide here in just a minute. But this last one here says to be consistent. And I feel like you don't want to necessarily be so rigid that there's not the ability to maybe learn from mistakes or critique yourself, your own trading style and unique process.

But I think for me, when we're talking about being consistent, the easy way I like to talk about that is we just need to know what success looks like, which oftentimes is positions growing or on a chart what we call up and to the right. Whereas when it comes to knowing what being wrong looks like, which oftentimes is very, very challenging, but it's how we can try to preserve our capital and look for additional opportunities.

Now on the next slide here, we'll talk more about the position sizing, some additional things to consider, some of which I had already talked to and some of which might be already perhaps common sense to some of you or things that we've learned about this previous month. But what I'd say one of those last bullet point talks about if you can't sleep at night, position being too large, I'd certainly echo that sentiment.

I've been there before, you place a trade, all of a sudden your heart starts pounding. Chances are maybe position's a bit too large, or you're really hoping the position works out rather than going into it with conviction knowing when you're going to enter and exit for better or worse. And that's that emotional aspect, being able to utilize risk management, your position, size management, maybe even a little bit of cash on the sidelines, always looking for opportunities and being able to keep your portfolio growing over time.

So all in all, Nick, I think that when we think about position sizing, it's also going back to on the previous slide when we looked at different sectors, different geographies, different asset class types even, bonds, stocks, whatever it might be. There's a time and place for a little bit of everything in different portfolios, different accounts, and sometimes even different accounts within the same person.

I always joke that the way I'm invested with my-- I guess, risk management and time horizon, that's going to be vastly different than my old man who's retired and perhaps no longer going to be in his working years. So maybe he needs to be a little bit more conservative. And that portfolio or thought process is going to be completely different than that of my six-year-old boy at this point, who's got hopefully his whole life ahead of him to be able to invest, trade, and learn more about it.

So even within your own family, even within your own account types, accounts for retirement, accounts for savings, accounts for maybe a little bit of trading, you'd be able to then go ahead and have a clear thought process as to where this next dollar is going to go. It's all about that opportunity cost.

I always say I've got limited capital with a couple kids of my own, Nick, I know you've got some kids as well. So the assets that we have are not unlimited, which is why being able to look for opportunities, put certain amounts of assets to work, hoping for those profits, but managing risks and drawdowns, I think is what is so important. And concentration, keeping things small, staying up with the news and even some order types that we're going to learn about here in just a moment, I think are all things that have helped the most successful traders that I've worked with over the years.

But that being said, I know I peppered in a little bit about order types and gave that a teaser. You had already mentioned a little bit about it as well. We've already learned about market orders and limit orders. We're going to expand on that thought with stop orders, trailing stop orders, this, that, the other, Nick. So let me let you in on the conversation to keep us rolling here and introduce some of these thoughts for orders that can help with our trading activity.

**NICHOLAS DELISSE:** Absolutely. I couldn't agree more there, Peter. And one thing that I also can't stress enough is what you were saying about earlier that if you're just so stressed, you can't sleep at night because of a position is just so big worry what happens if that particular stock drops might be too big of a position, might be opportune to reduce that particular position size.

Shifting gears a little bit, let's start to talk about stop orders, specifically stop loss versus stop limit. If you remember last session, we talked about market orders and limit orders. That's really the big difference between these two particular order types. These orders are conditional orders. When the conditions met, it places an order.

With a stop loss order, in essence, if you have a \$100 stock and you say if the stock comes down to \$95, that is your condition. Stock trades at or below \$95 do x. And with a stop loss order what that is, is place a market order to sell. So \$100 stock, you place a stop loss order at \$95. The stock comes down \$100, \$97, \$95.25, \$94.99, well, that is at or below \$95. Boom, your stop is triggered the conditions. Met, it triggers a market order. You then sell at the next available market price.

With that being a market order, in essence, you're guaranteed that execution, so to speak, like a market order, but not necessarily price. If things are dropping really fast, you see it, \$95.50, \$95, \$94, just really fast. I have seen in the very early hours of the market when the market just opens, that it's just moving so fast. By the time the order is filled, it could be \$94.75. It's not going to be right at \$94.99, or \$95. It's going to be at that next available price.

Now, where this can also have a risk is what's called overnight gapping risk. Let's say the stock drops from \$100, \$97, \$95, that condition still hasn't been met. And then overnight, there's an earnings announcement. The stock opens the next day at \$90 a share. Well, the trade at \$90 is at or below \$95. You're going to execute the conditions been met. Market orders in place to sell the next available market price, which is \$90 a share, not \$95. This is one of those larger risks with stockholders.

In comparison, a stop limit order, as opposed to placing a market order, places a limit order. And what traders might do with something like this is if they notice that a stock comes down and it opens at \$90 and it rebounds up to \$94, well, what they might say is the condition is if it's at or below \$95 place the order, but the order won't place is to sell at \$94 or better.

What's going to happen is if the stock is just naturally marching down, \$95.25, \$94.99, well, it's going to place an order to sell it \$94 or better. You're going to go through right away at that marketable price. But if it gaps down to \$90, then the conditions been met. The trigger

happens. It now triggers a limit order to sell \$94 or better. So now the market has to come back up to \$94 before you sell.

Now, what's the risk with this? Because there's always trade-offs. There's always gimmes and gotchas. Well, the risk is the stock opens at \$90 and then goes to \$88, \$85, \$80, \$70-- keeps dropping. It never comes back up to \$94. Your order never fills. And I remember saying this with some really well-known blue chip companies in the Dow Jones, where they just dropped and dropped and dropped and dropped and dropped.

And if you had a stop limit order would have been hanging at \$300 a share, while the stock then dropped to almost \$100. So there's risks and tradeoffs. Many traders might use a stop limit order to avoid getting whipsawed, as it's called, where it comes down and then comes back up, but the risk is if it doesn't whipsaw, if it keeps dropping, you could be left holding the bag. And for many traders, the more important thing is actually getting out, not price.

So if it's dropped, you've made that conscious decision to, hey, if it drops \$5 or 5% or whatever it might be to get out, well, that's going to be more important. It's actually getting out versus trying to achieve a particular price. Now, there are other condition orders in addition to stop loss, stop limit that traders might use. And some of the more popular ones are trailing stop orders.

What these are like is a great example, I like to use is if you're walking along the beach, say, where you're at is \$100 and you reach behind you and you place a rock at \$95, \$5 behind you. Well, if you walk forward, you walk forward, you walk forward to \$105, \$110, \$120. And you start backing up, backing up, backing up. You have to back up quite a ways until you hit your rock that you placed at \$95.

But what if you reach behind you, you place that rock, but you tied a string. That rock. So now as you walk forward. It's that \$5 long string. You walk forward from \$100 to \$103, you drag it forward a little bit. And now, as opposed to being at \$95 is at \$98. You walk forward to \$112. Well, now it's at \$107. And it keeps going. It keeps going as you drag it forward.

Now, if you start to back up, does the string push it back? Well, no, it sits right where you left it. So if you walk forward to \$112, the string drag it up to \$107. You back up to \$105. Well, as soon as you hit \$107, that triggers it. And that's what a trailing stop order does.

Now, the example we have on our slide is a little more simplistic than that than the string example. It then talks about that you're buying a stock at \$25 right here. And then the stock goes up to \$27, and you're worried about you wanting to protect your gains, protect against the loss. And so what you then do is you set up a trailing stop order that if it drops by \$1 to get you out.

When you first place the order at \$27 trailing by \$1, well, if it drops back to \$26, it's going to get you out. But as the stock goes up, then see this gets lifted up a little bit higher and it goes from \$27 to \$28. Really \$27.75 just kind of gets moved up. As it drops back down, this stays flat. Your trailing price doesn't drop. It's a high water mark.

But then as it recovers and comes back up to \$29, well, your \$1 trail gets lifted up to \$28. And then as price drops, \$29, \$29.50-- sorry, \$28.50, \$28.75, \$28 right here. As soon as it hits \$28, your condition has been met at your trigger price, triggers a market order. You then sell out. Now, these trailing stop orders typically done at either dollar thresholds or percent thresholds. Why might this matter? Why might this be beneficial? Well, in our original example, we talked about that \$100 a share trailing \$5 to \$95. Well, the stock kept going up, kept going up, kept going up. And now you're at \$200.

Well, \$5 is \$195. Or if it's 5%, that's actually \$190. And many traders, they might start to employ some technical analysis techniques or going back to Dow theory and such, where they're looking for-- where you might have correction territory or bear market territory, in which case, they might let a stock keep going up. But then once it pulls back 10%, 8%, 12%, 20%, well, then they'll sell out.

So the 10% example, \$100 stock trail it \$90, 10%. As the stock goes up to \$150, well, now your trail is at \$135 versus \$140. It's 10% back, 10% down and such. And this might be what traders will leverage and utilize on a percentage basis as opposed to dollar basis.

This kind of goes back to where many traders are so focused on buying in at a good price, as opposed to when to get out. This is a little bit acceptable where you might not have a specific pricing. I'm going to get out. I got it \$100, I'm going to get it at \$103. You might say, well, I'm wanting to let it go up because I'm longer term bullish, but if it pulls back a certain percentage, well, that's when my exit criteria has been met and I do want to get out.

With that said, Peter, there's so much that we can cover, we can talk about from a technical analysis perspective. Anything you might want to add as we talk about stop orders and such before we move forward?

**PETER JANSSEN:** Yeah, I think just with that theme on technical analysis, this is the classroom where we're trying to introduce trading concepts. We're trying to introduce different ways to classify assets, different asset classes. But we do offer a number of additional sessions on technical analysis. In particular, there's an entire four week and month long classroom on technical analysis. Lots of our sessions that we run on a daily basis-- incorporate those concepts as well.

So I think that having that dollar amount or percentage amount as far as understanding how stops work-- the trailing stops work is extremely important. It's a great outline. It's utilized by professional and retail traders every single day. We also want to keep in mind that, well, maybe a 10% trailing stop amount would be better served if it was at roughly 11% or 12%, or 9%.

And that's because, well, maybe there is some type of area of importance via the chart or technical analysis that could be some concepts of trend, like watching for price action, respecting a moving average, that could also be horizontal areas of importance such as

support or resistance. You could also start to incorporate maybe some different measures of volatility. There's what's referred to as average true range.

And with the new Fidelity Trader Plus software, different indicators actually do lots of that heavy lifting for you where you can look at those gauges of volatility-- what volatility has been. And then rather than picking some type of arbitrary number such as 5%, 10%, whatever it might be. Maybe you want to look at the volatility and the characteristic of the actual stock itself and relatively how much it moves.

And then take perhaps some type of multiple of what that volatility is. And I know that starts to take it a little bit further, but that really gets into the fun of technical analysis indicators and all that's available to you with the new platform. So that being said, Nick, there's different order types. There's different ways for us to approach it. Possibilities are somewhat endless, but I think it goes back to having some type of outline, a framework for the trades and investments that you're looking for.

And then finding an efficient way to go ahead and make those actionable so that you can hold yourself accountable. But I think you're going to go ahead and potentially walk us through some of these order types, some of the ways to place these trades on that software. So once again, let me take a step back here and let you back in on the conversation.

**NICHOLAS DELISSE:** Sounds fantastic. Let's go ahead and segue and take a look at Fidelity Trader Plus. Now, there's both a desktop version and a website version. And we'll mostly stick around the website so everyone can follow along with us. With this, of course, I'm looking at Microsoft right now. And there are a couple of quick things we can leverage to get ideas of where we might want to place our particular stop orders.

Now, we do have some very nifty tools. Of course, one of them is powered by our cognitive pattern analysis. If we come up over here, we click on Analysis. We can now click on Support or Resistance. And this will add some algorithmically generated support resistance levels to our particular chart where we might be interested in setting a stop level at or below a particular resistance point.

One thing that we teach a course in technical analysis is with support resistance, a resistance where I should say a support is level that a stock will come down-- it tends to want to bounce off of-- tends to be a floor that this stock doesn't want to go through. But then when it does, was a support becomes a resistance and then the stock struggles to go up above and beyond that.

Like Peter mentioned, if you want to learn more about this, I strongly encourage you to take a look at some of our technical analysis classes that we do have. One thing to keep in mind when it comes to these particular support resistance levels is they're based on closing prices. As such, today, we might have seen a stock drop below yesterday's closing price, and it could be trading below a particular support because we don't have a closing price today, or it could have shot and be trading above a particular resistance point.

So definitely keep that in mind that this particular tool looks at closing price information. When you're setting this, you can, of course, mouse over, see some additional information if you so desire where those levels might be. Now, to start to place some of these more complex conditional orders, one very popular type of order is what's called a bracket order, or a one cancels the other type order.

Within Fidelity's Trader Plus platform, what I've done over here on left hand side, I have our positions that are test account does have in here. One of those positions, of course, at the very top, we see Bank of America, BAC. What we can then do is we can click on these three little dots right here. And from here, we can go to set exit plan. And this will launch up a trade ticket for us where we can set an exit plan.

With this, this is a conditional type order. We can then look at other conditions if we so want. And from here, we can, of course, say, we have our sell order for both a stop loss and a sell limit target. Now, from here, shifting down, we'll do shares first. We have five shares in our test account. This populates it in both sides.

And maybe we say, well, if Bank of America comes back over here to this other high that we had, that \$54 range, well, let's go ahead and sell at that \$54 per share. Or if Bank of America drops down here to this \$49, let's go ahead and pull the rip cord, stop us back out. We can then say our stop price is \$49 right there. And this is set up a bracket that if it goes down, we get stopped out at \$49.

Well, our sell target order has been canceled and it just gets us out. Or if it goes up to \$54 and our targets been met, we sell at that profit threshold, while our lower level stop order is then canceled, so it's one or the other is placed from this particular perspective.

Now, there are other ways to place these types of more complex conditional orders. And naturally straight from your positions page on the website is another way to do this. And we also have something that's called a one triggers, a one cancels the other type order.

Simply clicking on the top left-hand corner. Trade up here will start to slowly fill out this particular trade ticket, with stock in our individual account. We have one account in our test account. Then from here, let's shift gears and we'll look at Microsoft again. One of those top five components in the S&P 500. It's a Dow 30 component as well. And then we'll scroll down.

And from here, we'll do something like a buy, but we can also do order type-- shift order type to conditional. And from conditional, this will have some different types of conditional orders. One cancels the other type order, or we can even do a one triggers, a one cancels the other type order.

Now, we don't actually have Microsoft in our account. But from here, when it comes to setting up that trading plan, what we could say, well, let's buy Microsoft. We want to buy 10 shares at a limit price. Remember, last week we talked about market versus limit order. We

can say, well, if Microsoft comes back down to maybe 422 a share, just drops just a little bit, back to close that the previous market period.

Well, from here, if it drops back down to \$422, we're going to buy. And if the buy does fill, let's set up some sell orders to manage our risk. Now, it's pre-filled down here. The quantity of 10 shares just like up here. But now we have some sell targets, or maybe we then say, as a limit price, it goes up to \$430 a share. Up above, ring the cash register. It's a \$7 gain. Or I should say it's an \$8 gain, purchasing it \$422, \$7 from where we are right now.

Or if this happens to drop down and trades at or below \$420 a share, pull the parachute rip cord, get us out of the position. And this is what's called a one triggers, a one cancels the other type of order where we set it up, where going into the trade. If it does fill this original order being a day order, it's then going to trigger these two good till canceled risk management orders that it drops into the \$2 exit out, or if it goes up \$8, go and ring the cash register and close out of that particular position.

So quite a few ways you can, of course, manage your risk, whether you're using the regular trade ticket on fidelity.com. You're leveraging some of the more advanced tools and more advanced charting capabilities within the Fidelity Trader Plus ecosystem. But that said, what I'd strongly encourage you to do is continue to grow your knowledge and learn more when it comes to technical analysis, when it comes to fundamental analysis as such, and we definitely offer some other classroom sessions that you can take advantage of those sessions.

With that though, thanks for joining us for our fourth part of this four-week long session, and we definitely look forward to seeing you for future sessions. Take care, everyone.

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