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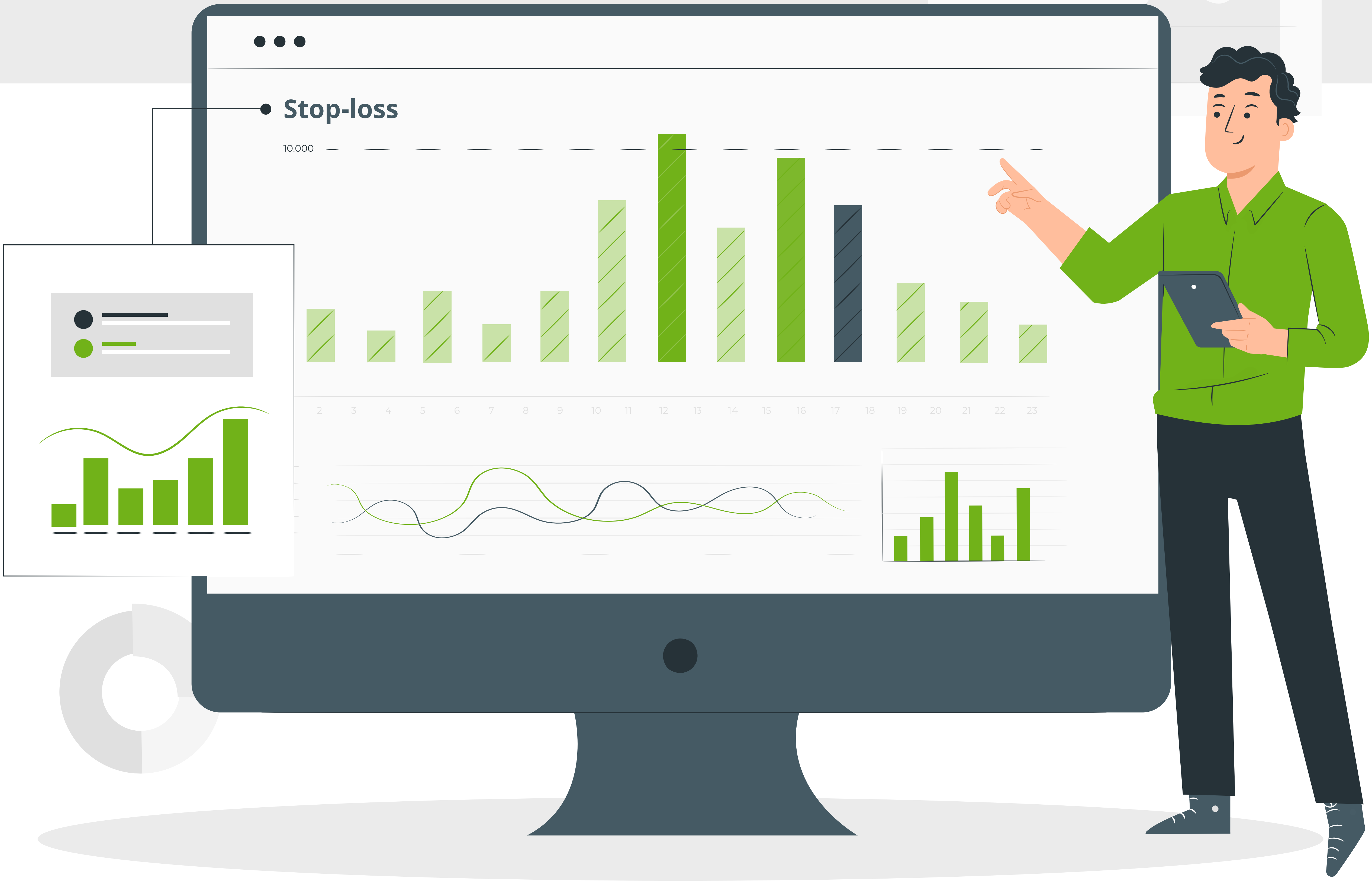
Stop-loss order

Should I use?



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Intro

SUMMARY

Using stop-loss orders in Forex trading is one of the most frequent questions among the novice traders. Should I use stop-loss orders and how often? There is no definitive answer to this question in open sources, which is why Traders Union experts decided to conduct their own research to find out how often successful traders use stop-loss orders in their trading and how important it is for building a trading strategy.

In order to obtain an unbiased and fair answer to the question of the research, the team of TU analysts surveyed 1,500 successful traders, trading with the top brokers from among the TOP 10 of the TU's rating. As a result, objective, reliable data were received that reflect the opinion of successful traders, using different trading strategies in the Forex market.

BENEFITS OF THE RESEARCH

The conducted research answers the following questions:

- What is a stop-loss order?
- What types of stop-loss orders are used in the Forex market?
- Opinions existing in open sources on the topic of the research.
- Do experienced traders use stop-loss orders in long-term and short-term trading strategies?
- Should I use stop-loss orders in my trading strategy?

The traders from across the world will be able to use the results of the research for successful trading.

Glossary

- **Forex** is a global financial market for exchanging currencies. The participants of Forex trading include central banks of different countries, companies, top international businesses, commercial banks and private traders.
- **Forex broker** is a financial services company performing the function of an intermediary between the buyer and the seller of currency in the Forex market.
- **Stop-loss order** is an order placed with an objective to limit losses once a specified price is reached.
- **Trade deposit** means the funds deposited by a trader to his/her account with a Forex broker.
- **Volatility** is a term used to describe fluctuations of trading prices within a specified period of time. It is believed that the higher the range of price fluctuations, the higher the volatility.
- **Slippage** is the difference between the expected price of a trade set by the trader and the price at which the trade is executed.
- **Spread** is the difference between the best buy price and the best sell price in currency exchange.

Opinions available in open sources

When studying the issue of using the stop-loss orders in the Forex market, TU experts analyzed open sources, including opinions of respected traders of the past and the present (Alexander Elder [1], Larry Williams [2], Jesse Livermore [3], Jack Schwager [4], John Murphy [5]), and also articles on the popular websites (investorplace.com [6], seekingalpha.com [7], marketwatch.com [8], etc.). TU analysts have reached a conclusion that there is no agreement of opinion regarding the use of stop-loss orders in the strategy in the open sources. Well-known traders, such as Alexander Elder, Larry Williams, Jesse Livermore, Jack Schwager and John Murphy believe that the stop-loss order is an essential instrument for building a profitable trading strategy. Financial experts, however, such as Matt McCall, Dan Moisand and Dane Bowler believe that stop-loss orders are not only unnecessary, but they inflict damage on the trading in the financial markets.

For example, in his book Long-Term Secrets to Short-Term Trading, Larry Williams, world champion of trading, recommends setting the stop-loss order once the price breaks the local peaks and not to risk more than 2% of the deposit.

Larry Williams

At the same time, well-known trader Jesse Livermore, the Great Bear, claimed that the stop-loss order needs to be set at no more than 10% of the deposit.

Jesse Livermore

In his Triple Screen Trading System, Alexander Elder says that the stop-loss order on an open position should be 3 times lower than the expected return and should not exceed 2% of the deposit. At that, in case the price moves towards return, the stop-loss order needs to be shifted to break even, i.e. use the trailing stop-loss.

Alexander Elder

Financial experts Matt McCall, Dan Moisand and Dane Bowler have a different opinion. They believe that the use of stop-loss orders is not only unnecessary, but also harmful for trading in the financial markets.

In this articles, Matt McCall, President at Penn Financial Group states [9]:

Matt McCall

> … I often get asked at what level should a stop-loss order be set? At what price? Or at what percentage pullback?
>
> My answer is always the same … do not set one.
>
> Nearly every investment professional will tell you that it is imperative to use a stop-loss order to protect yourself from sudden losses. I completely disagree…

Dane Bowler [10], Director of Analytics at 2MCSC, agrees with him:

Dane Bowler

> … We see stop losses and other triggered actions as the equivalent of hiding under a blanket. They may make one feel better, but they do not provide any measurable risk mitigation. In fact, they seem to increase risk as they have the potential to force trades at adverse prices…

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Dan Moisand [11], Financial Planning Expert at Moisand Fitzgerald Tamayo, also shares the opinion of the stop-loss order opponents:

Dan Moisand

> … While the term "stop-loss" sounds perfect for value preservation, in practice it is not great…

TU experts have set a task to find out which of the above opinions is true and whether stop-loss orders should be used when building a trading strategy.

Theoretical part of the research

Stop-loss order is primarily designed to minimize the losses once the price of a financial instrument (asset) moves in the direction of a loss after the trade was opened. Once the price of the asset reaches the stop-loss level, the opened position will be exited automatically. For exiting long positions, the Bid price (demand price of the asset) is always used, and for short positions – Ask price (supply price). When the stop-loss order is executed, the whole position, for which it was set, will be closed.

THERE ARE A FIXED STOP-LOSS AND TRAILING STOP-LOSS ORDERS:

A **fixed stop-loss order** can be based on the following:

- Trading pattern or price channel;
- volatility;
- pips;
- percentages

Stop-loss based on a trading pattern or price channel.

The stop-loss order is set under the minimum (over the maximum) of the trading pattern or just outside the price channel. It implies that when the price goes beyond the pattern or channel, the price will continue to move in the unprofitable direction. Therefore, it is believed that the trader is better off closing such a position.

Stop-loss based on volatility.

It is set based on the average volatility, typical for the financial instrument in the recent period. This type of fixed stop-loss order implies that if the volatility of a financial instrument rises sharply, then it is better for the trader to register a certain loss and exit the trade. After all, there have been market events or some news that the trader could not have foreseen when opening this position.

Stop-loss based on pips or percentages.

Day traders are the ones who use this type of stop-loss orders most frequently. It is implied that the trade will be closed, if the price moves towards a loss by a specific number of pips or percent.

Trailing stop-loss order is always set at a certain distance (in pips) from the position opening price and is shifted (trails) along with the price, if the price moves towards a profit. If the price reverses, the trailing stop-loss order is not shifted, and the trade is closed with a profit. Trailing stop-loss is believed to be a good alternative to the fixed stop-loss order.

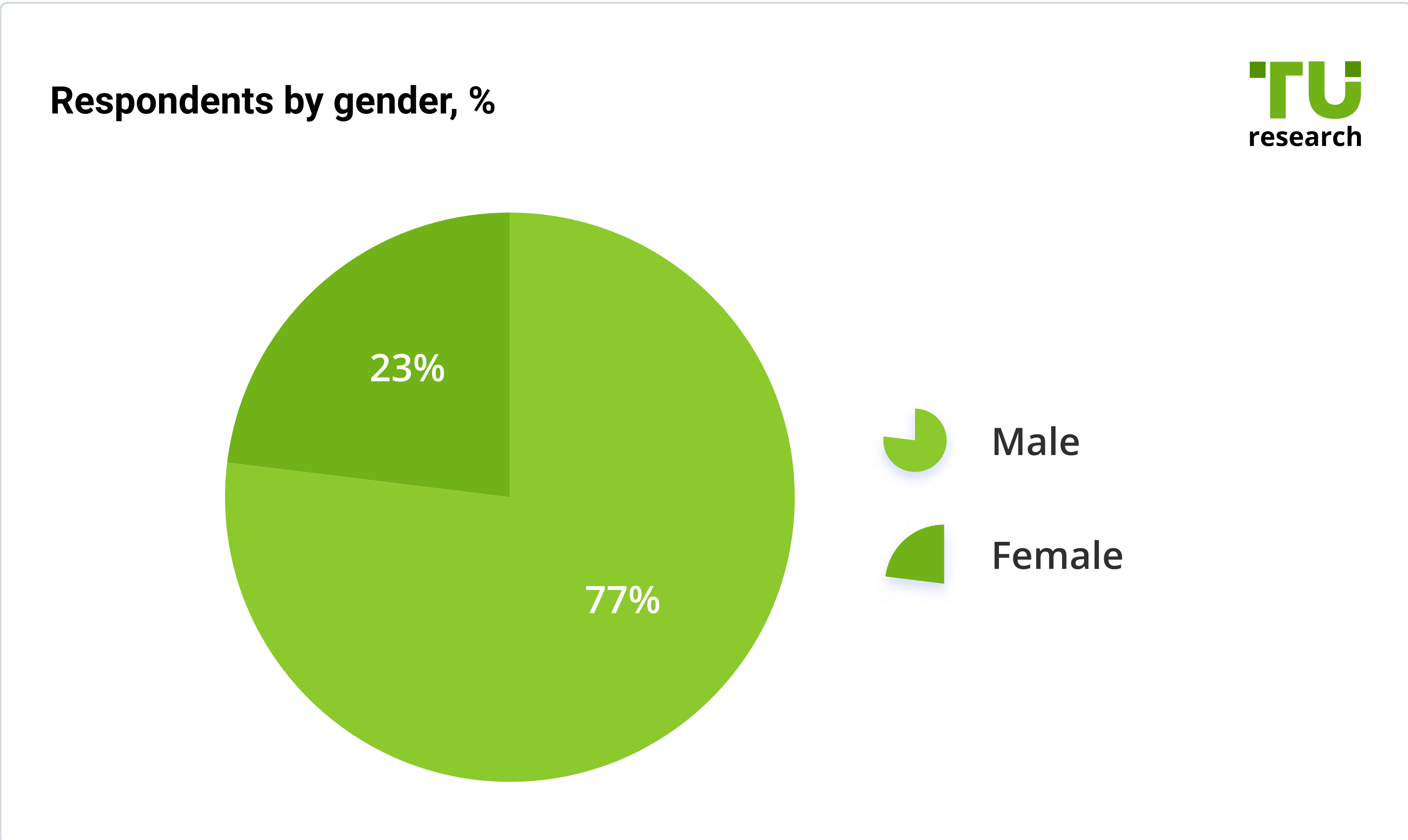
Note:

TU experts note that when setting the stop-loss order, a trader needs to take into consideration the spread and the possible slippage during execution of such types of orders.

Results of the research by TU Research Department (*)

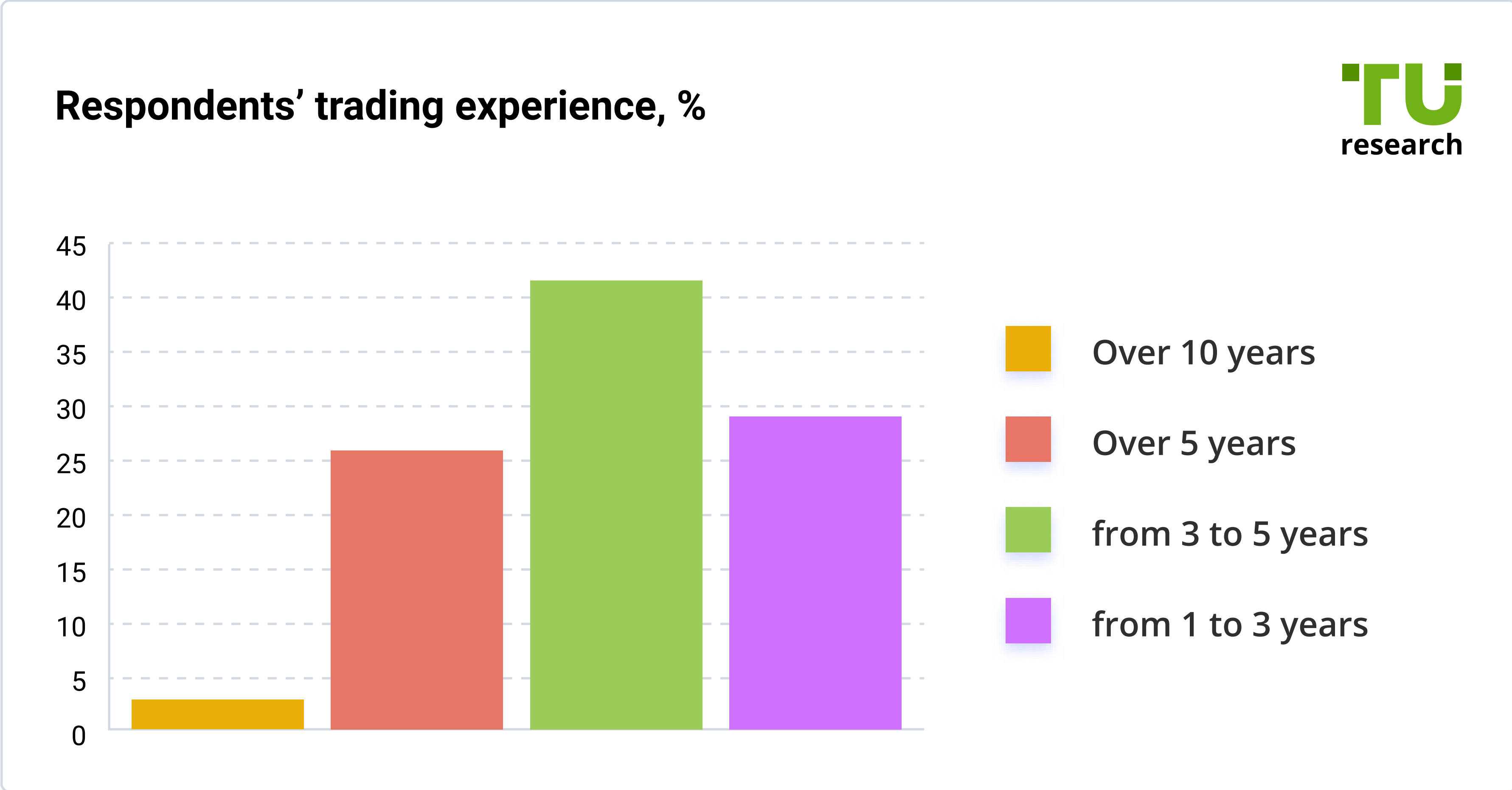
To answer the question of whether it is worth using the stop-loss order when trading in the Forex market, the team of TU analysts surveyed 1,500 successful traders – members of the TU community. The survey was conducted using CAWI (Computer Assisted Web Interviewing) method. The non-sampling error of the survey with a confidence level of 0.95 is no more than 2.5%.

The respondents from different countries were offered to fill out a structured questionnaire, sent to them via email. All surveyed traders have shown profitable trading for at least one year. Among the respondents who participated in the survey, 77% were men and 23% were women.



Picture 1. Respondents by gender, %

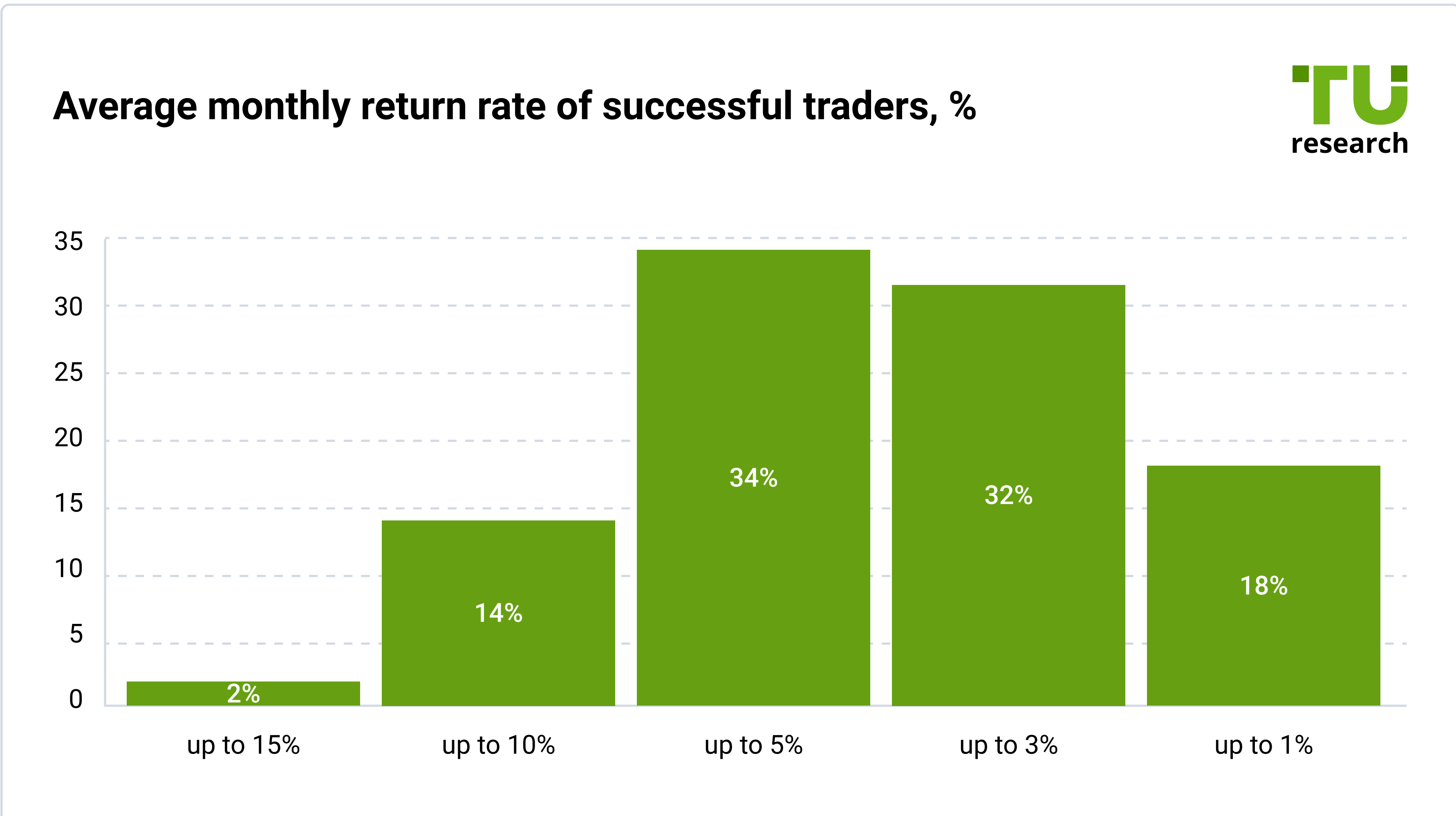
In terms of their trading experience, the composition of the respondents was as follows: 3% of the respondents have been trading on Forex for over 10 years, 26% – more than 5 years, 42% – from 3 to 5 years and 29% – from 1 to 3 years.



Picture 2. Respondents' trading experience, %

According to the survey, the average monthly deposit growth for the last 6 months among the surveyed traders is as follows:

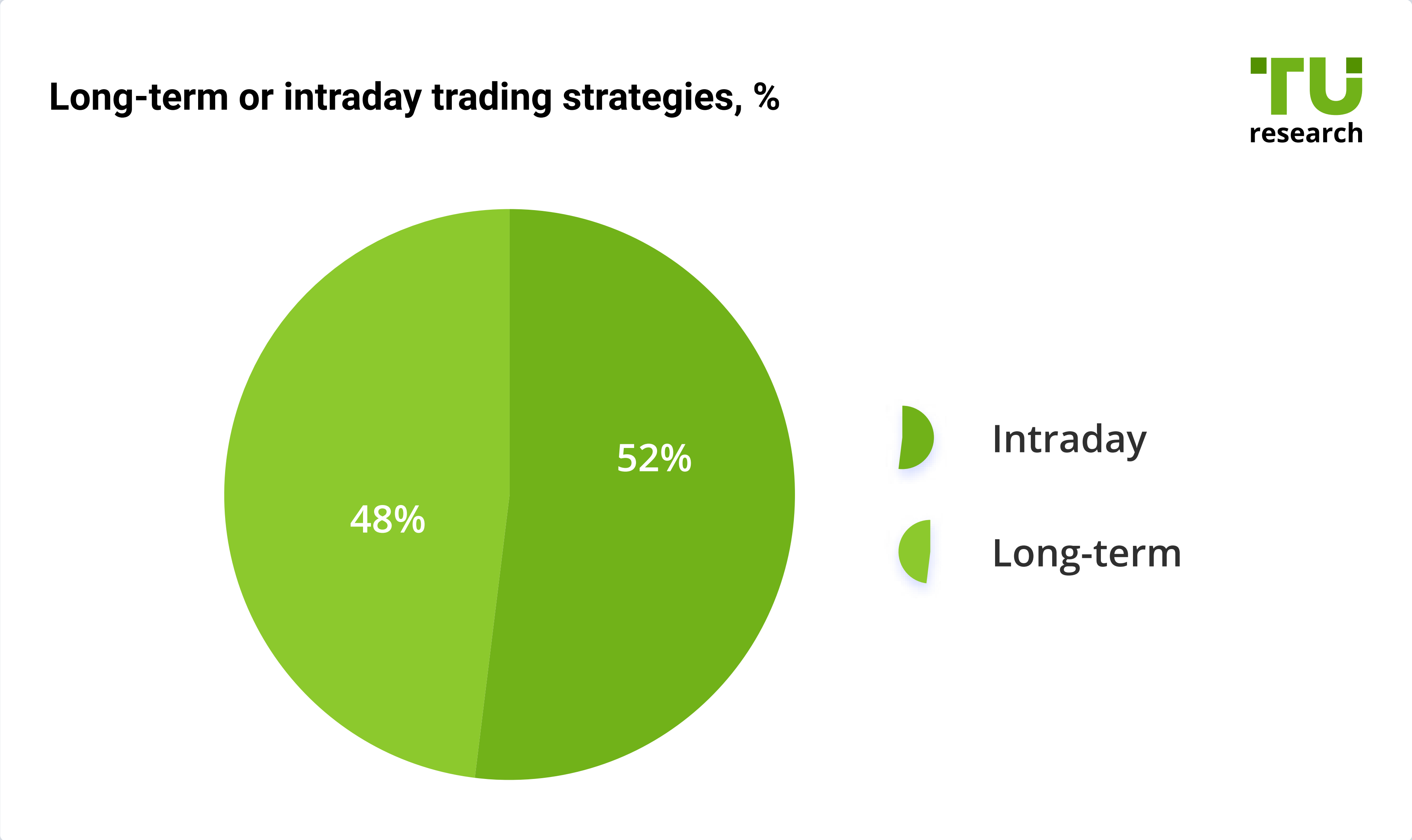
- 2% of respondents have shown an average monthly return of up to 15%
- 14% – up to 10%;
- 34% – up to 5%;
- 32% – up to 3%;
- 18% – up to 1%.



Picture 3. Average monthly return rate of successful traders, %

The responses of the respondents regarding their trading strategies were as follows:

- 48% of the respondents use long-term strategies;
- 52% – intraday.



Picture 4. Long-term or intraday trading strategies, %

To the question: **"Do you use stop-loss orders in your trading strategies?"**, the respondents answered as follows:

Gender, Experience	Male		Female		Over 10 years		Over 5 years		3-5 years		1-3 years	
	Votes	%	Votes	%	Votes	%	Votes	%	Votes	%	Votes	%
Yes, I do	786	68%	174	51%	34	76%	241	62%	403	64%	282	65%
No, I don't	231	20%	98	28%	6	14%	86	22%	132	21%	105	24%
I use stop-loss orders sometimes	138	12%	73	21%	5	10%	62	16%	94	15%	50	11%
Total	1155	100%	345	100%	45	100%	389	100%	629	100%	437	100%

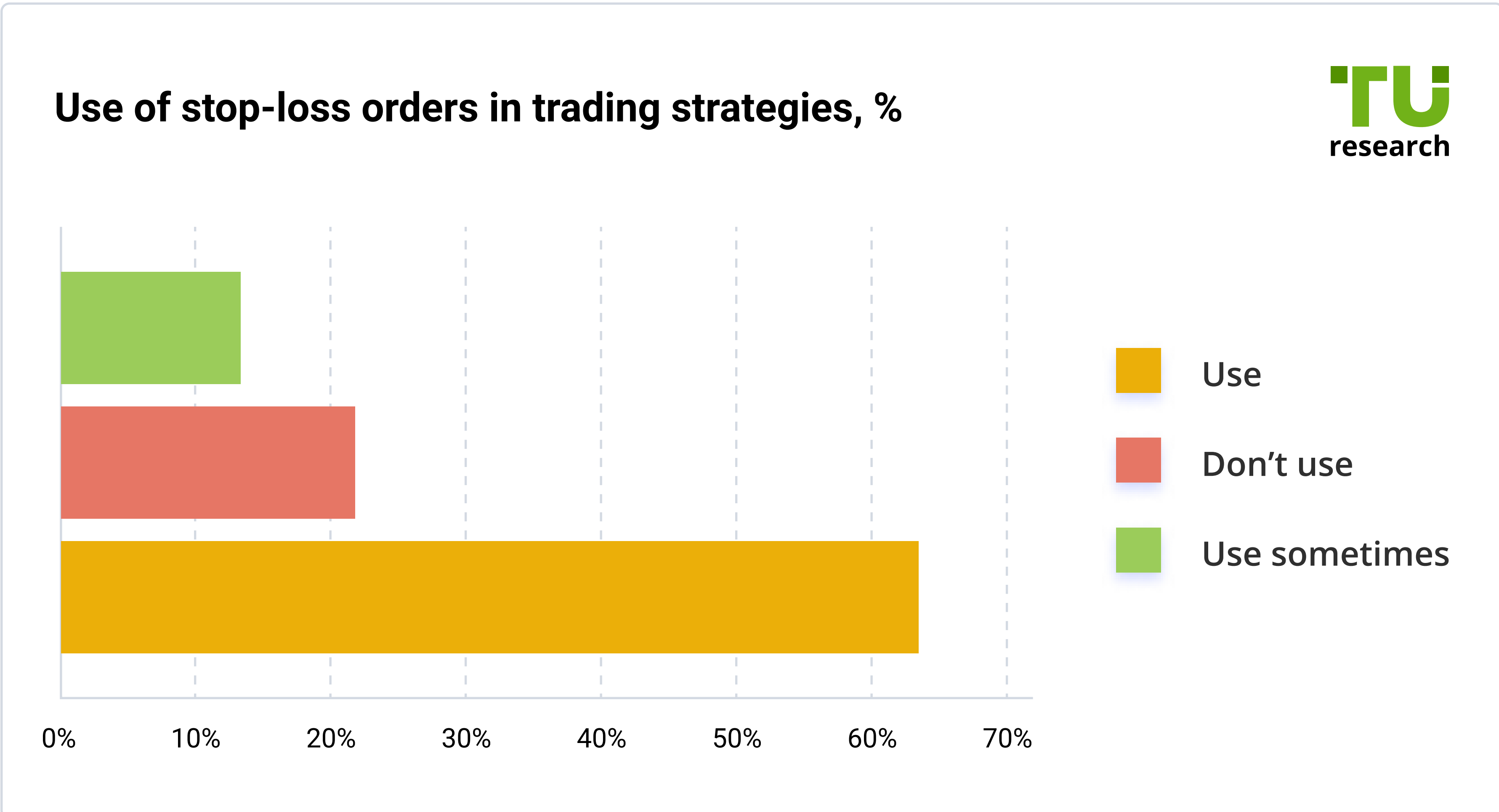
Table. 1 Responses by gender and forex trading experience.

Return rate, Strategy	Long-term strategies		Short-term strategies		Return up to 15%		Return up to 10%		Return up to 5%		Return up to 3%		Return up to 1%	
	Votes	%	Votes	%	Votes	%	Votes	%	Votes	%	Votes	%	Votes	%
Yes, I do	469	65%	491	63%	21	71%	147	70%	321	63%	311	65%	160	59%
No, I don’t	165	23%	164	21%	7	23%	51	24%	107	21%	95	20%	69	25%
I use stop-loss orders sometimes	86	12%	125	16%	2	6%	13	6%	81	16%	72	15%	43	16%
Total	720	100%	780	100%	30	100%	211	100%	509	100%	478	100%	272	100%

Table 2. Responses by strategy type and monthly return rate.

The generation distribution of answers for the question regarding the use of stop-loss orders in the trading strategy is as follows:

- 64% – Yes, I do use the stop-loss orders;
- 22% – No, I don’t use the stop-loss orders;
- 14% – I use the stop-loss orders sometimes.



Picture 5. Use of stop-loss orders in trading strategies, %

The respondents who ‘use’ or ‘sometimes use’ stop-loss orders were also asked what type of stop-loss orders they use. The answers were as follows:

Gender, Experience	Male		Female		Over 10 years		Over 5 years		3-5 years		1-3 years	
	Votes	%	Votes	%	Votes	%	Votes	%	Votes	%	Votes	%
Fixed	407	44%	143	58%	24	61%	124	41%	244	49%	158	48%
Trailing stop	249	27%	90	36%	9	24%	97	32%	179	36%	54	16%
Both types	268	29%	14	6%	6	15%	82	27%	74	15%	120	36%
Total	924	100%	247	100%	39	100%	303	100%	497	100%	332	100%

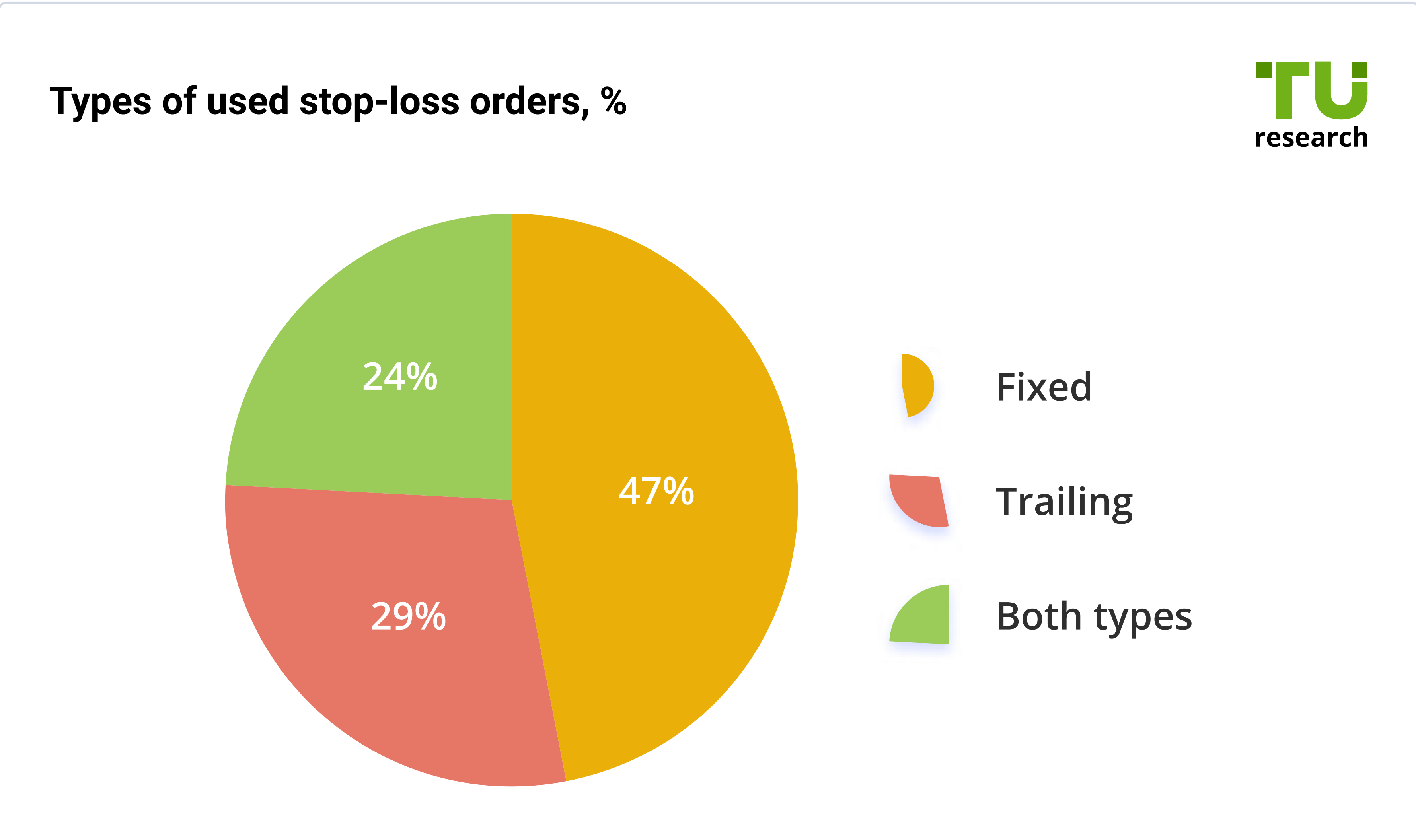
Table 3. Responses by gender and forex trading experience.

Return rate, Strategy	Long-term strategies		Short-term strategies		Return up to 15%		Return up to 10%		Return up to 5%		Return up to 3%		Return up to 1%	
	Votes	%	Votes	%	Votes	%	Votes	%	Votes	%	Votes	%	Votes	%
Fixed	317	57%	233	38%	17	74%	64	40%	185	46%	165	43%	119	59%
Trailing stop	209	38%	130	21%	5	22%	40	25%	85	35%	130	34%	79	39%
Both types	29	5%	253	41%	1	4%	56	35%	132	19%	88	23%	5	2%
Total	555	100%	616	100%	23	100%	160	100%	402	100%	383	100%	203	100%

Table 4. Responses by strategy type and monthly return rate.

Among those, who use stop-loss orders in trading in the Forex market:

- 47% use fixed stop-loss orders;
- 29% using trailing stop-loss;
- 24% use both types of stop-loss orders depending on the market situation and the size of the open position.



Picture 6. Types of used stop-loss orders, %

(*) Survey criteria

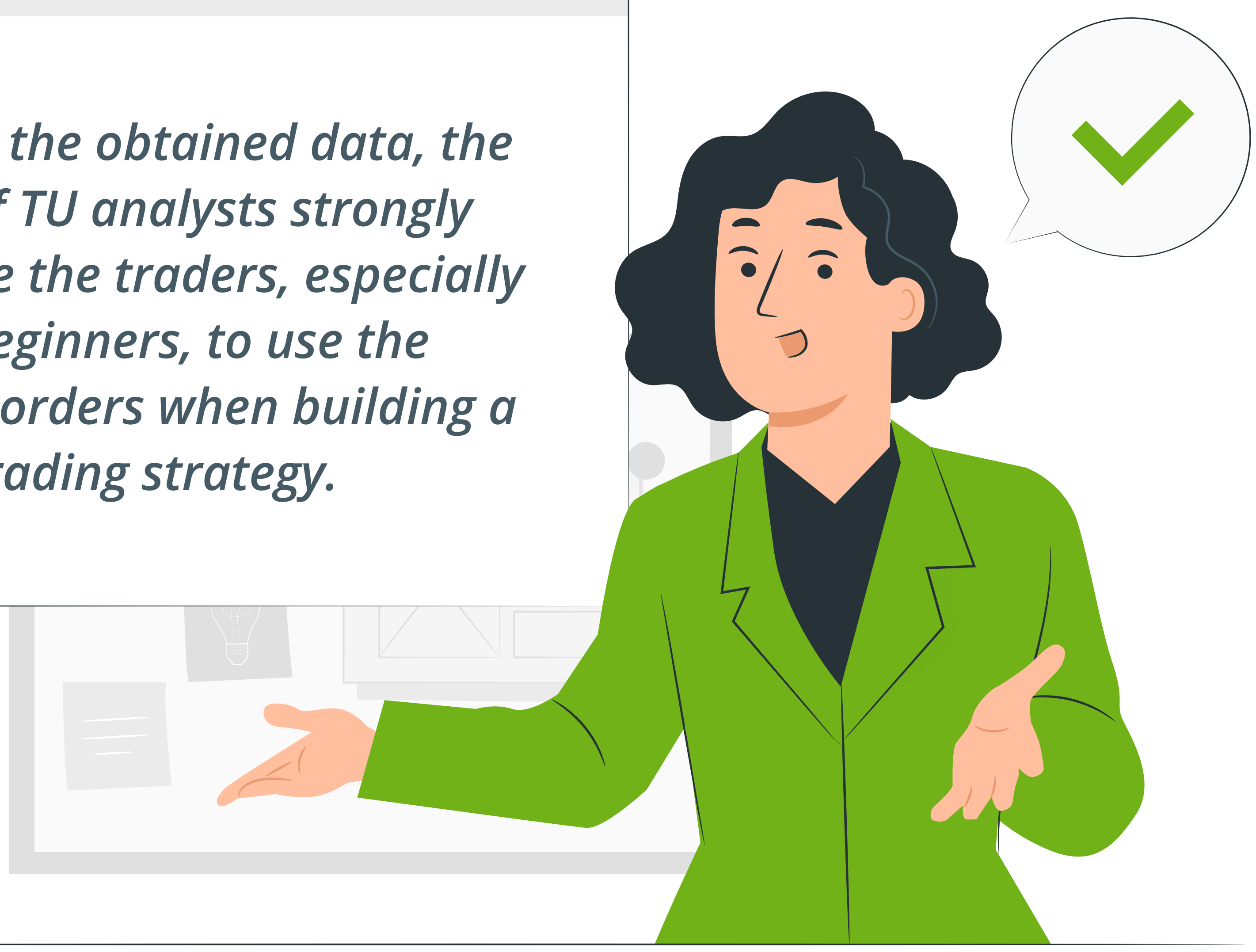
- Survey audience: Forex traders of the TU community aged 18 and older trading with the brokers from the TOP 10 list of TU.
- The sample is representative in terms of age, gender and Forex trading experience.
- Sample number: 1,500 respondents.
- Survey method: CAWI (Computer Assisted Web Interviewing).
- Non-sampling error of the study with a confidence level 0.95: no more than 2.5%.
- Period of survey: May 11-12, 2021.

Findings

In summary, the findings of the research conducted by the TU experts are as follows:

1. An overwhelming majority of successful traders use (or partially use) stop-loss orders in their trading strategies, specifically 78% of the respondents.
2. Most frequently, the surveyed traders use fixed stop-loss orders (47% of the respondents, who use (or partially use) stop-loss orders, which is 37% of the sample number).
3. The traders who prefer long-term trading strategies use fixed stop-loss orders more often.
4. Traders who prefer short-term trading strategies use both types of stop-loss orders depending on the market condition and the opened trading position.
5. The results received in the course of the research do not depend on the gender of the trader and their trading experience in the Forex market. The majority of men and women, regardless of their trading experience, are of the same opinion: one should use stop-loss orders when trading in the Forex market.

Based on the obtained data, the team of TU analysts strongly encourage the traders, especially the beginners, to use the stop-loss orders when building a trading strategy.



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