



Disciplined Trading Strategies

By Paul Lange

The “R Unit”

We frequently discuss the measure of a trade in “R Units”. It is really the best to discuss a trade and understand how effective the trade was. Naturally, what matters to an individual is how much money was made. But making a thousand dollars on a trade can mean a drastically different thing to a person with a 5,000 dollar account compared to a person with a 5,000,000 dollar account. Hence the term “R Unit”, that compares what you made with what you risked; the only real measure of a trade.

Question: When we say we had a 3R trade, what does that mean?

Answer: When we refer to how many “R”s were made on specific trades, we are referring to the ratio between how much risk you had on that specific trade (meaning distance from your entry point to your stop loss) vs. how far the stock moved in your favor on that specific trade.

Example: 25 cent stop with a 75 cent profit is a 3R trade.

Example: 50 cent stop with a 150 cent profit is a 3R trade.

Example: 10 cent stop with a 30 cent profit is a 3R trade

Example: 50 cent stop with a 25 cent profit is a ½Rtrade.

Example: 50 cent stop with a 50 profit is a 1 R trade.

Question: OK, that was pretty simple, but what about this “R Unit” that we talk about?

Answer: In your trading plans, you should have a pre-determined maximum amount of money that you are willing to risk on any trade. That maximum amount of money, we define as an “R Unit”.



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Again, when we refer to “R Units”, we are referring to the maximum amount of money (\$) that you will risk on any given trade.

If you have decided at your level of trading you want to risk \$200.00 per trade, that \$200.00 represents 1 “R Unit”.

Now that you have that “R Unit” defined, whenever you find a quality set up, if you want to use a fixed R unit, you should take that “R Unit” and divide it by your stop, in order to determine the appropriate share size.

Example: $\$200.00 \text{ risk amt} \div .50 \text{ stop} = 400 \text{ shares.}$

Example: $\$200.00 \text{ risk amt} \div .10 \text{ stop} = 2000 \text{ shares.}$

Example: $\$200.00 \text{ risk amt} \div .20 \text{ stop} = 1000 \text{ shares.}$

Example: $\$200.00 \text{ risk amt} \div .25 \text{ stop} = 800 \text{ shares.}$

When using the “R Unit” system properly, you should never take a trade risking more than 1 “R Unit” per trade. The risk that you use is another topic; it should start small and grow with your experience. We have used \$200.00 in our examples so far.

How many R’s you make on a specific trade (in dollars) should normally equate to how many “R Units” you made (on the chart), if share size management was used properly. However, if you do not use the appropriate share size, the “R” vs. “R Unit” will not be equivalent. In other words, if your risk amount was \$200.00 and your stop was \$.20, and you hit a target of \$.60, the target was 3 times the stop (60/20) so ‘on the chart’ you made 3 Rs. That will only translate to a 3R profit of \$600.00 (3 time your \$200.00 risk) if you share sized properly.

$\$200.00 \text{ risk} / .20 \text{ stop} = 1000 \text{ shares.}$

$1000 \text{ shares times } \$.60 \text{ profit on chart} = \$600.00 \text{ profit in account.}$



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Note, if you decided to take a lesser share size for some reason, then on the next trade you take the proper share size but it is a loser, you may end up with the actual money not equaling the total of your 'Rs'.

Special Note: Whenever you are using this "R Unit" method for determining share size, you should always take into consideration possible slippage. Consider this trade with the same \$200.00 risk and a \$.20 stop, so you take 1000 shares. But if you got in late by 5 cents, and you stopped out with slippage of 5 cents, your 1000 shares will now be a loss of \$300.00, not \$200.00. So either know your stocks and allow for the estimated slippage going in, or use an R amount when calculating share size that is actually a little lower than what you are really willing to risk.