

How to Set the Perfect Stop Loss

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To say 2018 was a rough year for cryptocurrencies would be an understatement of epic proportions.

After exploding in 2017 and hitting new highs in December of that year, the crypto market began a nosedive that lasted through 2018. From January through September, the crypto markets crashed a whopping 80% — making for a steeper decline than even that caused by the dot-com bubble burst.

It's no great surprise that the No. 1 thing most investors in 2018 found themselves thinking was that they wished they'd used a stop loss.

Stop losses aren't only for volatile times.

Even in bullish markets, stop losses are useful tools in hedging against risk.

In an inherently fickle market like cryptocurrencies, they could be your lifeline against some pretty catastrophic losses.

So, if you're a crypto investor without a stop loss strategy, it's time to start implementing one.

Here's what you need to know...

What is a stoploss?

Most investors are familiar with the concept of stop losses as it relates to buying and selling stocks.

But you can use them for cryptocurrency investments, as well.

A stop loss is an order to sell out of a position when your trade reaches a certain price. You set it when you first enter a trade. As the name suggests, it's designed to limit losses if the trade moves against you. The idea behind utilizing stop losses is to limit compounding your losses.

Let's break this down further:

- ◆ **Stop** – this is the price the asset must reach before your limit order goes into effect.
- ◆ **Limit** – this is the price that your trade will automatically try to sell at. It's important to note that you won't always sell your assets at this exact price. If the markets have moved quickly, or if there are no orders at that price, the asset will sell at the closest price available.
- ◆ **Amount** – the total number of coins you're selling at that price.

Let's look at an example.

Say you're interested in buying a set number of tokens of Cryptocurrency A, which are currently trading for \$20 apiece, but you want to protect yourself against market volatility. When you purchase your token, you can enter a stop loss order of a certain dollar amount or percentage. For the purposes of this example, let's say you set a stop loss at \$18.

If the crypto price dips to \$18 or below, your stop loss will be triggered and your coins will automatically sell at the next available price.

If you work with a broker, he or she will set the order for you. But you can also do it yourself on crypto investing platforms such as Binance.

Here's an example of what that would look like:

The screenshot shows a trading interface with a 'Stop-Limit' order type selected. The interface is split into two panels: 'Buy VEN' and 'Sell VEN'.

Buy VEN Panel:

- BTC Balance: 0.00004976
- Stop: 0.00008925 BTC
- Limit: 0.00008925 BTC
- Amount: (empty) VEN
- Percentage buttons: 25%, 50%, 75%, 100%
- Total: 0.00000000 BTC
- Button: Buy VEN

Sell VEN Panel:

- VEN Balance: 23313.11355000
- Stop: 0.00008100 BTC
- Limit: 0.00008000 BTC
- Amount: 23313 VEN
- Percentage buttons: 25%, 50%, 75%, 100%
- Total: 1.86504000 BTC
- Button: Sell VEN (with a mouse cursor pointing to it)

At the top right, there is a fee indicator: Fee: 0-10% 0.050%.

Benefits of using stop losses

Limiting your losses is a crucial endeavor as an investor. The cold hard fact is that the greater the loss, the more expensive it is to come back to the point of breaking even — even greater than the percentage of the loss itself.

How Much It Takes To Come Back From A Loss

Percent Loss of Position	Percent Gain Needed To Get Back To Even
-5%	5.3%
-10%	11.1%
-15%	17.6%
-20%	25%
-30%	33.3%
-40%	66.7%
-50%	233
-60%	300%
-70%	400%
-80%	567%
-90%	900%

In addition to managing your overall risk and validating your original investment thesis, stop losses protect you while you're sleeping. Or on vacation. Or wherever. In other words, they remove the need for you to monitor daily what's happening to each individual asset in your portfolio.

They also take the emotion out of investing. If you feel emotionally connected to a particular asset for whatever reason, it can be hard to sell out of the position, even if all signs point to disaster. Setting a stop loss can prevent you from becoming emotionally entangled in your investments and help you stay focused on gaining profits and preventing losses.

Types of stop losses

There are four primary kinds of stop losses.

1) The Chart Structure Stop

This type of stop (as you might imagine) is determined by chart structure and calculated based on target. Some targets you might base your stop on include:

- ◆ Support/resistance
- ◆ Moving averages (EMA/SMA)
- ◆ Supply/demand zones

- ◆ Swing highs/swing lows
- ◆ Fibonacci Levels (1.272, 1.618, 2.618)

Chart Structure Stop Bull Reversal

In this case, enter above the candlestick confirmation. If it's a big candle, place it 50% or 61.8% in the middle of the candle.



2) The Volatility Stop

Volatility is the rate at which a market will change in price. In highly volatile markets, rates change quickly. In low-volatility markets, rates change slowly.

With a volatility stop, you set your stop loss based on the market's current volatility range and trends. In a more volatile market, you use wider stop losses (to avoid being stopped out of a position based on wild price fluctuations that have more to do with the market than the asset). In less volatile markets, you'll use tighter stops, since price movements are more likely to be reflective of the asset's underlying fundamentals.

When you take on wider stops, you also take on greater risk. So, you'll want to keep your position sizes smaller. You also may not want to wait until your stop is triggered to get out of the trade — which means keeping a closer eye on your positions.

3) The Time Stop

With a time stop, you're basing your stop loss on your overall thesis, and whether that thesis is confirmed or not over a set period of time.

If you enter a trade based on a structure, momentum, or moving average, and your thesis isn't confirmed over a set period of time, then exit the trade and wait for a better setup.

The idea is — very simply — to get out of a trade if it's not acting in the way you expected.

You don't actually set time stops to be automatically triggered. Rather, you've got to monitor your positions to ensure they're doing what they should.

If your analysis changes, that means the original trade idea has been invalidated. In this case, don't wait for your stop to be hit — get out immediately.

4.) The Money/Measured Stop

This is very simply when you use the same stop loss for every trade. With this method, your risk is the same throughout your portfolio.

If you're into scalp trades, where you're looking to make profits on small price movements, you'd probably want to consider a stop loss of 1–2%. If you prefer swing trades, which are longer term and more focused on trends, you can set wider stops of 4–10%.

I don't recommend this strategy as I prefer to use stop losses below chart structures, as I've written about in this guide.

Market orders vs. limit orders

There are a couple different orders you can use to set a stop loss: **market orders** and **limit orders**.

A **stop loss market order** is set at a specific price. If the asset hits the strike price of the market order, the order will automatically be triggered to sell at the closest price available.

Let's say you buy an asset for \$25 and place a stop loss market order for \$24.50. But then some news emerges about the asset that causes investors to pull any buy orders above \$24. The asset price falls to \$24.50, but no one is willing to buy above \$24. Your stop loss triggers at \$24.50 and searches for the closest order to the market order strike price. In this case, it would sell for \$24 (a \$1 loss per coin).

However, the next closest buy order could be as low as \$20. The asset would sell for that price at a \$5 loss per coin — a much more substantial loss than the actual price of the market order.

This type of event is called “slippage,” and it does happen. Typically, though, a stop loss market order will execute at or near the desired price — especially if the asset trades at a high volume.

With a market order, you will always be able to sell a losing asset. However, it could potentially be for substantially lower than your set price, particularly in a volatile market.

Then you have **stop loss limit orders**.

Like market orders, stop loss limit orders are set at a specific price. However, unlike market orders, limit orders can only be executed at the strike price or higher. Because of this, they're not guaranteed to be filled (if the asset can't be sold at the strike price). As such, they won't automatically get you out of a losing trade.

Using the same example as above, let's say you purchase an asset for \$25 and set a stop loss limit order for \$24.50. If the stop loss triggers, the order will try to sell the asset at \$24.50 (or higher if a price becomes available).

However, if the asset falls below \$24.50 and there are no buy orders at that price, the stop loss limit order will not execute — leaving the investor in the trade and potentially accumulating further losses if the asset price drops even lower.

Long story short: a **stop loss market order** prioritizes getting out of the trade, while a **stop loss limit order** prioritizes the price of the asset.

One is not inherently better than the other. Depending on the context, both are valid approaches to stop losses. So how do you know which is best for your investment? Much of it will be based on your own tolerance for risk, and which type of risk seems more worth taking.

Alternatives to traditional stop losses

Stop losses aren't a one-size-fits-all solution. If the standard stop loss model doesn't feel like the right fit for you, there is a variety of alternatives to suit your specific investing needs. These are:

Trailing stops

With trailing stops, you don't set a strike price at a particular dollar amount. Instead, you set a percentage or dollar amount below the market price.

If the asset price moves up, so too does the trailing stop.

Let's say you buy an asset at \$10 and set a trailing stop of 5%. At the time of purchase, that stop price would be \$9.50. So, if the asset price dropped below that level, the stop would be triggered.

But say instead that the asset moved up to \$12. The 5% trailing stop "trails" the price of the asset, and would go up to \$11.40.

Then, if the asset dropped again in price (say, to \$10.50), your trailing stop would be triggered to sell the asset at the highest strike price it reached before falling again (\$11.40).

Using a trailing stop is a great way to lock in gains while hedging against losses. Most people use trailing stops of 3–5% (lower for scalp trades).

Stop limit alerts

Stop limit alerts are exactly what they sound like: alerts to let you know when an asset reaches a certain price. These are different than standard stop losses because an order to sell won't automatically be triggered. Instead, you have the opportunity to evaluate the price movement to see if it's a stop run/flash crash... or whether it's a real move to the downside, invalidating your trade idea.

These are good in an up-trending market but not ideal in a down-trending market, since they don't offer the inherent protection of an automatic sell order.

Delayed stop losses

These are also exactly what they sound like. They offer the ability to add a timed delay to your sell order if your stop loss is triggered.

This is particularly useful in a volatile market, or with an asset that has wild price fluctuations (which we all know is often true of cryptocurrencies) or low liquidity.

Flash crashes are a commonplace occurrence. An asset can fall 20% or more in a one-minute candle before bouncing back to the entry price. Adding a five-minute delay to your stop loss would prevent a flash crash due to low liquidity, or for getting you out of a winning trade if the price bounces back.

This type of stop loss is only available with software like 3commas.

Candle closing stop losses

Some traders who use a daily 240-minute (H4) use something called a “candle body closing stop.”

You set an alert and you manually close your position ONLY if the H4 candle closes below your stop limit position.

A 15-minute or one-hour candle close doesn't matter.

You can go beyond your stop, but this type of stop loss allows “time” to correct itself before you must make a decision.

How to determine a stop loss: Simple rules to follow

The most important component of any stop-loss strategy is to have one. Other than that, there are no hard and fast rules or magic equations to figure out exactly how to determine where to set your stop. But here are a couple simple guidelines:

1. Always determine your stop when entering a trade

Depending on your investing strategy, you may want to consider placing your stop at a recent low point in price for the asset. If the asset is currently trading at its lowest price, you may want to give it a little time to go up a bit, to make sure it's heading in the right direction. If you're correct in your investment thesis, the price should continue to move up from that low point. If the price moves lower than its latest low, then you may be incorrect in your thesis, and your stop will protect you against even lower prices.

2. When it comes to risk vs. reward, position size matters

The size of your position should help determine your stop loss. For larger positions, you'll want to use smaller stops, lest you risk bigger losses. For smaller position sizes, you can afford to take on a little more risk with a larger stop loss.

If you use a larger stop loss than normal, the potential rewards should justify the additional risk. For particularly large stop losses, consider taking on just a 1/2 position. If you're worried about your stop triggering, then consider lowering your position size.

Stop loss strategies: Bull markets vs. bear markets

Your stop loss strategy will vary depending on the state of the markets. The risk vs. reward setup is wildly different depending on whether we're in a bear or bull market. It's important to consider market trends when determining your stop loss strategy.

Bull trends

Setting stops in a bull trend is fairly straightforward. Since the market is moving up, you can expect the asset to move in the same direction, and if it doesn't, your stop loss will protect you against substantial losses.

When the market is bullish, set your stop below the asset's prior low, and trail the stop at each swing low. If the asset drops again, but the new "low" is higher than the prior low, it supports the bull trend. However, if the asset drops to an even lower low, it's time to exit the trade — either your thesis is incorrect, or the bull trend may be over.

Using trailing stops in a bull trend is a great way to lock in gains as the market continues to move up. If you're doing so, you'll want to:

- ◆ Tighten your stop (move it up closer to current price)
- ◆ Raise your stop to just below the most recent higher low
- ◆ Trail it below the most recent bull candle bar
- ◆ Look for a support level (Fib/Pivot/Moving Average)
- ◆ Use a specific percentage (3–5%)
- ◆ Or even move your stop to break even for a risk-free trade





Bear trends

Bear trend stops are a little trickier because you're counting on an asset moving up while the market moves down. But even in a declining market, you can still make a profit. You just have to be smart about it.

In this case, you'll want to set your stop just above the recent lower high price, and continue to trail the stop above each swing high. That way, if the asset moves higher, you can exit the trade lock in the gains if it were to drop in price again.

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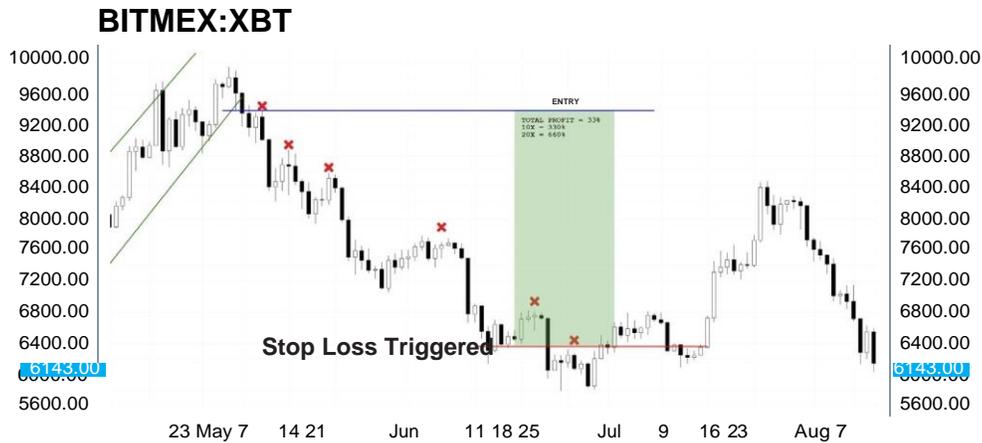


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If you're interested in counter trend stop strategies, you can allow a trend to go against you once. But if it moves against you twice, it's a sign that the trend will continue and it's time to exit the position.

Summing Up

After the year the crypto markets have had, it's easy to see why stop losses should be in every trader's tool belt.

Investing is all about taking on risk in pursuit of reward. And that risk means that sometimes, losses are inevitable.

But they don't have to be crushing. You can mitigate your risk... cut your losses... and lock in your gains... all with a simple stop loss strategy.