Leverage on a violent instrument

> **EFFECTIVE LEVERAGE**
>
> Notional exposure divided by account balance - the honest measure of how geared a position actually is, regardless of what maximum the broker or exchange offers. It is a property of the position you chose, not of the account's permissions, and on a violent instrument it is the number that decides survival.

Module 3 kept margin out of the cost column. This lesson keeps leverage out of the danger column - and puts the right thing in it.

Leverage is a ratio you chose

The broker's 10:1 is a ceiling, not a setting. A single WTI contract against a large account might be 2:1 effective leverage; the same contract against a small one is 8:1 - identical instrument, identical margin, entirely different fragility. Divide notional by balance, per module 1's arithmetic, and the number that emerges is a decision you made when you sized, whether or not you noticed making it.

Why commodities punish the same ratio harder

A ratio that is comfortable on a currency pair is reckless on gas, because the instrument's range - lesson 3's subject - is several times wider. Effective leverage times typical daily range gives the fraction of the account that an ordinary day can move: the only leverage statistic worth computing. Five per cent of the account on a normal day is not a position, it is a countdown - and on a commodity that arithmetic arrives at ratios FX intuition calls conservative.

The clean ledger, extended

Margin: still a deposit, still not a cost, still not the risk - module 3 lesson 4 stands.Leverage: a chosen exposure ratio. Not dangerous in itself; dangerous multiplied by range.Range: the instrument's property. It cannot be negotiated, only sized for.

The sizing discipline from lessons 2 and 5 controls effective leverage automatically - risk-based size caps the ratio without anyone thinking about it. This lesson exists so the cap is understood rather than accidental: when volatility doubles and the sizing arithmetic halves the position, that is effective leverage being managed. The margin call lesson two ahead shows what happens to accounts that manage it by broker ultimatum instead.

Check your understanding

1. Two accounts hold one identical WTI contract each. One is fragile, one is comfortable. What differs?

a. The broker's maximum leverage

b. The balance behind the position - effective leverage is notional over balance, a property of the position chosen

c. The margin requirement

Answer: b. Same contract, same margin, same maximum - different denominator. The ratio that matters was set by the sizing decision, not by the account's permissions.

2. What single statistic best captures leverage danger on a commodity?

a. The broker's leverage ceiling

b. Effective leverage times the instrument's typical daily range - the share of the account an ordinary day moves

c. Margin as a percentage of balance

Answer: b. Leverage only bites through the instrument's movement. The same ratio is tame on a quiet pair and lethal on gas - multiplying by range is what converts a ratio into a survival number.