

The stop sized to the instrument's range, not a round number

AVERAGE TRUE RANGE

A rolling average of how far an instrument actually travels per period, gaps included. It is the standard honest answer to 'how much does this thing move' - and therefore the standard input to a stop that is a decision about the instrument rather than about the trader's comfort.

A stop's job is to be hit only when the idea is wrong. A stop inside the instrument's ordinary daily wander is hit when nothing is wrong at all - it is a donation with paperwork.

Range is a property of the instrument

Crude routinely travels more in a session than some markets manage in a month, and gas makes crude look sedate. The seed of every bad commodity stop is imported intuition: a distance that felt generous on a currency pair is inside the hourly noise of a commodity. The instrument's measured range - ATR is the workhorse - is the only defensible starting point, scaled by a multiplier that reflects how much ordinary wander the idea is prepared to sit through.

Round numbers are decoration

A stop at \$80 because \$80 is round, or one dollar away because dollars are tidy, encodes no information about the market. Worse, module 2 taught you the continuous chart's old levels can be splice artefacts - a 'support' that nobody ever traded is a particularly hollow place to park a stop. Range-based placement asks the only question that matters: how far does this instrument move when nothing is happening, and how much further before something demonstrably is?

The range changes, and the stop must

Commodity volatility is regime-shaped: a calm month and a supply-shock month are different instruments wearing the same symbol. A stop distance set in the calm regime and reused in the loud one is inside the noise again - the ATR moved and the stop did not. Wider stop, same budget, means fewer contracts. The size absorbs the regime; the risk number never does.

Work the numbers below: an ATR, a multiplier, a distance, and what that distance does to cash at risk. Then hand the distance to lesson 2's arithmetic - which is the whole system, joined.

Worked example - figures in USD

A US dollar account of \$100,000 risking 2%, placing a stop at twice an ATR of \$2.10 on a dollar-quoted commodity.

1. The instrument's ATR is \$2.10 - its measured ordinary travel. A 2 multiplier places the stop \$4.20 away: outside the noise, by a chosen margin.
2. The account risks 2% of \$100,000: \$2,000. That budget and this distance now go to the sizing arithmetic - the stop was set by the instrument, the size gets set by the budget, and neither borrowed the other's job.

Check your understanding

1. What makes a stop distance 'honest'?

- a. It limits the loss to a round amount
- b. It sits outside the instrument's measured ordinary range, so ordinary noise cannot reach it
- c. It matches a support level on the continuous chart

Answer: b. A stop's job is to be hit only when the idea is wrong. Inside the daily wander, it is hit by weather - and module 2 showed why old chart levels can be splice artefacts besides.

2. Volatility doubles. The risk budget stays fixed. What adjusts?

- a. The risk budget doubles to match
- b. The stop widens with the range, and the size shrinks to keep the risk constant
- c. Nothing - the original stop still stands

Answer: b. The instrument sets the distance; the budget sets the money; the size is the shock absorber between them. It is the only variable that should move with the regime.