Sizing for the gap, not the stop

> **GAP-ADJUSTED SIZING**
>
> Sizing a position against the distance the market can travel while you cannot act, rather than against the stop you placed. The arithmetic is identical to ordinary sizing; only the distance changes, and the resulting position is smaller.

The previous lesson said size is the only control left after the close. This is what using it looks like, and it is the same division you already know.

Substitute the distance

Ordinary sizing divides the risk budget by the stop distance. Gap-adjusted sizing divides it by the gap distance - the move you might actually suffer, not the one you asked to be stopped out at.

Worked example - figures in USD

A 10,000 US dollar account risking 1%, sized against a 60-point overnight gap rather than a 20-point stop, at $1 a point.

1. Size against the gap instead of the stop: not the 60 points you chose, but the distance the market can travel while you cannot act.
2. One contract at $1.00 per point is $1.00 a point to you, so 60 points is $60.00 per contract.
3. The same $100 budget now buys 1.6667 contracts, so 1. The position is smaller because the risk being sized against is the real one.

Choosing the gap distance

There is no correct number, because the next gap's size is not knowable. What is available is history: how large have this index's overnight gaps been, and how often.

A typical gap tells you what most nights look like and is the wrong input, because sizing is about the bad case.A large historical gap is a better input, and still only a sample of what has happened rather than a bound on what can.Whatever you choose, write it down. A number chosen deliberately can be revisited; one chosen in the moment cannot.

The obvious objection

This makes positions smaller, sometimes much smaller, and a smaller position makes less when the trade works.

That is true and it is the trade being made. The alternative is not a larger position with the same risk - it is a larger position with a risk you have decided not to measure. The arithmetic does not care which you prefer.

The intraday exemption

A position opened and closed inside a session never meets this risk, so sizing it against a gap is over-caution rather than prudence.

Which means the honest rule has two branches: size against the stop for positions that will be closed today, and against the gap for anything held overnight. The same account can run both, and most of the confusion in risk discussions comes from applying one branch's answer to the other's question.

Check your understanding

1. What changes between ordinary sizing and gap-adjusted sizing?

a. The risk percentage
b. The distance the budget is divided by
c. The contract size

Answer: b. The arithmetic is identical. Dividing by the gap distance instead of the stop distance produces a smaller position for the same budget.

2. Why is a typical historical gap the wrong input?

a. It is too hard to measure
b. Sizing is about the bad case, and a typical gap describes the ordinary one
c. Typical gaps are usually zero

Answer: b. Most nights are unremarkable, and sizing exists for the nights that are not. A large historical gap is a better input, while still being a sample rather than a bound.

3. Should an intraday position be sized against the gap?

a. Yes, consistently for all positions
b. No - it will be closed before the gap can happen, so that is over-caution
c. Only on Fridays

Answer: b. The rule has two branches: against the stop for positions closed today, against the gap for anything held overnight. Most confusion comes from applying one branch's answer to the other's question.