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Stop Loss

Beginner's Guide

Sell Stop

- Sets a command to sell a position if it hits a certain price. When the position reaches the stop price, the order executes and shares or contracts are sold at the current market price.
- The sell-stop is always placed below the position's market price.

Sell Limit Order

- Sets a command to sell a position if a specific price is reached. As long as the price does not fall below the limit specified the order will execute at the limit price or higher. When the position reaches the stop price, the order is converted into a limit order, which is executed at the specified limit price or better.
- The order does not get filled if the position does not reach the specified stop price.

Let’s think deeper...

- The sell-stop and sell-limit sound very similar, it can be hard to remember which is which. There is an important difference. A sell-stop would be executed at the next available market price, after reaching the sell stop point.
- The sell-limit order would not sell at the market price, it would sell at the specified limit you manually put in or better, never lower. The proper use of sell-stop and a sell stop-limit order lowers the risk and protects your investments (up to a certain point).

- These tools keep the decision-making process simple and unemotional, even when the market is in turmoil. There are two common strategies or methods to choose a price point to place these stops at, but be aware there is no magic number for any stock or price point.
- The first method is to place your form of stop loss below the support level. Identify a support level by looking at a chart and finding where it stopped falling during prior downturns. A break below this price often means the position will head even lower before reversing.
- The second method is to place the stop loss 5% to 15% below the purchase price, depending on the investor's comfort level this can be smaller or larger.

Remember

Theoretically, stop-loss methods lower the likelihood of a catastrophic loss. In addition, identifying the potential downside in advance allows the investor to prepare for a worst-case scenario. This is the foundation to the majority of risk management gameplans.

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