Trading to Stops

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The use of trading stops is a common practice in financial markets for a variety of reasons: it reduces the frequency of trading and thereby transaction costs; it provides a simple way to control losses on a given trade, while also ensuring that profit-taking is not deferred indefinitely; and it allows for model recalibration to take place.
In this study, we try to explain why the use of stops may be desirable, by proposing a simple objective to be optimized. We investigate a number of possible rules for the placing and use of stops, either fixed or moving, with fixed costs, showing how to identify optimal levels at which to set stops, and compare the performance of different rules.