

Template: Monte Carlo Simulation Evaluation Checklist

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Based on Article: "Complete Guide to Evaluating Trading Strategies with Monte Carlo Simulation"

Website: <https://nairafx.ng>

A practical checklist for evaluating trading strategies using Monte Carlo Simulation.

Checklist Items:

- 1. Prepare Data**
Gather and clean trade-level records, including entry and exit timestamps, P&L, position size, and transaction costs to ensure credible inputs for the simulation.
Reference Section: Preparing Your Strategy and Data for Monte Carlo
- 2. Normalize Returns**
Store returns as percent return per unit capital. Capture absolute P&L for more accurate capital-growth modeling.
Reference Section: Preparing Your Strategy and Data for Monte Carlo
- 3. Add Cost Adjustments**
Incorporate explicit commissions and estimate slippage based on recent market measurements to compute realistic net P&L per trade.
Reference Section: Preparing Your Strategy and Data for Monte Carlo
- 4. Run Standard Backtest**
Conduct a traditional backtest to record key metrics such as CAGR, max drawdown, and Sharpe ratio, establishing initial performance benchmarks.
Reference Section: Why Monte Carlo Simulation Matters for Traders
- 5. Conduct Monte Carlo Simulation**
Use randomized return-order permutations and sampled return distributions to analyze potential strategy outcomes beyond the backtest.
Reference Section: Practical Walkthrough: Running a Monte Carlo Test (Step-by-step)
- 6. Analyze Metrics Comparatively**
Compare outputs from the backtest and Monte Carlo simulation across percentiles to assess downside exposure and adjust strategy expectations.
Reference Section: Why Monte Carlo Simulation Matters for Traders
- 7. Evaluate Sequence Risk**
Inspect the order and timing of returns from the Monte Carlo results to understand potential drawdown periods and recovery times.
Reference Section: Why Monte Carlo Simulation Matters for Traders
- 8. Adjust Risk Parameters**
Based on insights gained from the Monte Carlo simulation, modify position sizing, leverage, and reserve capital strategies for improved risk management.
Reference Section: Interpreting Results and Making Risk Decisions
- 9. Document Findings**
Record all findings, decisions made based on the simulation, and future recommendations for strategy adjustments.
Reference Section: Conclusion