Position Sizing II

Portfolio Construction, Exit Strategy & Rebalancing Across the Full Cycle — Q2 2026

The first report in this Position Sizing series established the foundational disciplines: the three-tier entry architecture, risk-adjusted sizing by asset tier, the Kelly Criterion adapted for crypto, and the specific adjustments required in bear market conditions. This second report addresses the questions that follow naturally from a well-constructed entry framework: how do you build a complete portfolio rather than managing individual positions in isolation, how do you determine when and how much to exit a winning position, how do you rebalance as market conditions change across a full cycle, and how do you manage the psychological dimensions of position sizing that undermine even technically correct frameworks in practice. Entry discipline is necessary. Exit discipline and portfolio construction discipline are equally necessary — and far less frequently discussed in the institutional literature on crypto investing.

01 — PORTFOLIO CONSTRUCTION: THE FULL ALLOCATION ARCHITECTURE

A portfolio is not a collection of individual positions — it is a system where each position interacts with every other position through correlation, liquidity, and psychological weight. Building a crypto portfolio without considering these interactions produces a collection of bets that may be individually rational but collectively incoherent — where positions that appear diversified actually move together during stress events, where the portfolio's total volatility far exceeds the sum of its parts, and where the investor's psychological capacity to hold positions is consumed by the aggregate complexity of managing too many simultaneous theses.

The institutional approach to crypto portfolio construction in Q2 2026 begins with a core-satellite architecture. The core — typically representing 60 to 70% of total crypto allocation — consists of Tier 1 assets: Bitcoin, Ethereum, and potentially Solana and XRP for investors with higher risk tolerance. These positions are sized for long-term holding through full market cycles, with entry tiers spread across the current bear market accumulation window and exit plans designed around the next cycle peak rather than short-term price targets. The core provides the portfolio's primary market exposure and the stability that allows the satellite positions to be held through volatility without requiring emergency liquidations.

The satellite — representing 20 to 30% of total crypto allocation — consists of higher-conviction Tier 2 positions in specific narratives or protocols that the investor believes will outperform the broader market in the next cycle. In Q2 2026, credible satellite candidates include RWA infrastructure tokens with verifiable on-chain revenue, AI agent infrastructure protocols with growing developer ecosystems, and

select DeFi protocols that have demonstrated sustainable fee generation through the bear market. Each satellite position is sized at 5 to 10% of total portfolio and managed with more active exit discipline than the core.

The remaining 5 to 15% — the speculative allocation — is reserved for high-risk, high-potential positions in emerging narratives where the investor has specific edge: early access to information, technical expertise in the relevant domain, or community involvement that provides insight not reflected in public pricing. Each speculative position is capped at 1 to 3% of total portfolio and treated as a defined-risk bet where total loss is an acceptable and pre-planned outcome rather than a catastrophe.

> ***PORTFOLIO ARCHITECTURE: 60–70% core Tier 1 assets held through the full cycle. 20–30% satellite Tier 2 positions actively managed for alpha. 5–15% speculative allocation capped at 3% per position. Total allocation to crypto should itself be sized relative to total net worth — not just relative to the crypto portfolio.***

02 — CORRELATION AND CONCENTRATION RISK IN CRYPTO PORTFOLIOS

The most dangerous misconception in crypto portfolio construction is that holding multiple different cryptocurrencies provides meaningful diversification. In practice, the correlation between crypto assets during bear market drawdowns approaches 1.0 — meaning that when risk-off conditions prevail, virtually all crypto assets decline simultaneously regardless of their fundamental differences. A portfolio that holds Bitcoin, Ethereum, Solana, five DeFi tokens, three AI agent tokens, and two RWA infrastructure tokens may appear diversified across twelve different assets and multiple narratives. During a macro risk-off event, it will move almost identically to a portfolio that holds only Bitcoin.

This high correlation has two important implications for position sizing. First, the diversification benefit of adding crypto positions beyond the first few diminishes rapidly — the marginal risk reduction from adding a tenth crypto position is essentially zero, while the complexity cost of managing ten theses simultaneously is significant. Second, because crypto assets are highly correlated to each other but have low to moderate correlation with traditional assets, the true diversification in a crypto portfolio comes from sizing the total crypto allocation appropriately relative to the investor's broader asset base — not from diversifying within crypto.

Concentration risk in crypto portfolios is best managed through three mechanisms. First, the core-satellite architecture described above naturally limits concentration by capping satellite and speculative positions at defined percentages. Second, the total crypto allocation as a percentage of total investable net worth — not just the crypto portfolio — must be sized according to the investor's actual financial resilience. An investor whose total net worth is $100,000 and who holds $80,000 in crypto is not a diversified investor regardless of how many different tokens they hold. Third, maintaining liquidity in the form of yield-bearing stablecoins within the crypto allocation provides a genuine non-correlated position that can be deployed opportunistically.

03 — EXIT STRATEGY: THE DISCIPLINE THAT DETERMINES REALIZED RETURNS

Entry discipline receives most of the attention in position sizing literature. Exit discipline determines whether paper gains become realized returns — and it is consistently where the largest performance differentials between disciplined and undisciplined investors appear. The investor who bought Bitcoin at $20,000 in 2022 and sold at $35,000 in 2023 did not benefit from Bitcoin's subsequent move to $109,000. The investor who held through the entire cycle, or who had a pre-defined exit framework that kept them in the position through intermediate volatility, captured the full move.

The institutional exit framework for crypto positions is structured around three distinct components: partial profit-taking at predefined price targets, position reduction based on portfolio weight drift, and full exit at defined invalidation conditions. Each serves a different purpose and operates on a different timeframe.

Partial profit-taking at predefined targets: For every position entered, a series of upside price targets must be defined before the position is opened — not after the asset has already moved and greed begins to distort judgment. A practical framework is to take 20 to 25% of the position off at each defined target, preserving the majority of the position for the full thesis to develop while locking in partial gains that reduce the average cost basis and lower the psychological pressure to hold through subsequent volatility. For core Bitcoin and Ethereum positions in a full cycle context, the appropriate partial take-profit levels are defined relative to historical cycle multiples from the halving low rather than arbitrary round-number prices.

Rebalancing-driven position reduction: When a winning position grows to represent a significantly larger percentage of the portfolio than its intended allocation — typically when any single position exceeds 1.5 times its target allocation — trimming back to the target allocation is a risk management discipline rather than a market call. This rebalancing approach has the additional benefit of being psychologically easier to execute than a conviction-based exit decision: the investor is following a predetermined rule rather than making a judgment about future price direction.

Full exit at invalidation: When the conditions that justified entering a position are no longer present — when the technical structure has broken, when the fundamental thesis has been disproven, or when the macro environment has shifted in a way that eliminates the basis for the original investment case — the position must be fully exited regardless of unrealized gain or loss. The failure to execute defined invalidation exits is the single most common source of catastrophic losses in crypto portfolios. Every bear market cycle produces a cohort of investors who held winning positions from the previous bull run through 80 to 90% drawdowns because they could not bring themselves to execute the exit that their own framework had defined.

> ***EXIT DISCIPLINE: Define three partial take-profit levels before entering any position. Define one full exit invalidation level before entering any position. Execute both mechanically, not emotionally. The plan written before the trade is more reliable than the judgment made during it.***

04 — REBALANCING ACROSS THE FULL MARKET CYCLE

A position sizing framework that is designed only for entry and exit management misses one of the most powerful tools available to long-term crypto investors: systematic rebalancing across the full market

cycle. Rebalancing — selling assets that have appreciated beyond their target allocation to buy assets that have declined below their target allocation — is a mechanical implementation of the buy-low-sell-high principle that most investors profess to follow but emotionally cannot execute.

In the crypto context, cycle-aware rebalancing means progressively shifting allocation from high-risk to low-risk assets as the cycle matures toward a peak, and from low-risk to high-risk assets as the cycle bottoms and begins recovery. An investor who held 70% Bitcoin, 20% Ethereum, and 10% stablecoins at the start of 2024 and rebalanced systematically as prices rose — selling crypto into stablecoins at 25%, 50%, and 75% gains from the prior cycle bottom — would have entered Q2 2026 with substantially higher stablecoin reserves, lower average drawdown from the peak, and greater capacity to redeploy capital at the next cycle bottom than an investor who held the same initial allocation without rebalancing.

The practical rebalancing schedule that produces the best risk-adjusted outcomes in crypto combines calendar-based and threshold-based triggers. Calendar-based rebalancing — reviewing and adjusting allocation quarterly — ensures that portfolio drift is corrected on a regular schedule regardless of market conditions. Threshold-based rebalancing — triggered when any asset class moves more than 10 percentage points from its target allocation — ensures that extreme market moves that produce rapid portfolio drift are addressed promptly rather than waiting for the next quarterly review.

In the current Q2 2026 bear market environment, the rebalancing priority is building stablecoin and cash reserves — the opposite of the sell-crypto-into-stablecoins rebalancing that was appropriate during the 2025 bull run. Investors who did not rebalance out of crypto during the 2025 peak are now in a position where their crypto allocation has declined as a percentage of total portfolio due to price depreciation. The appropriate response in many cases is not to buy more crypto immediately but to define the rebalancing levels — the price ranges at each tier of the entry architecture — at which systematic redeployment from stablecoins back into core crypto positions will be executed.

05 — THE PSYCHOLOGY OF POSITION SIZING: WHY CORRECT FRAMEWORKS FAIL

The technical elements of a position sizing framework — entry tiers, Kelly calculations, portfolio allocation percentages, exit targets — are the easier part of the discipline. The harder part is the psychology: maintaining the discipline to follow a pre-defined framework during the market conditions that make deviation feel most justified.

The two psychological failure modes that destroy position sizing discipline are fear of missing out during upward moves and loss aversion during downward moves. Fear of missing out causes investors to deploy Tier 2 and Tier 3 capital prematurely — abandoning the tiered entry architecture because the asset appears to be moving higher without them, only to have the asset reverse and leave them fully invested at a worse average price than the first tier entry. Loss aversion causes investors to hold positions beyond their defined invalidation levels — rationalizing that the thesis is still intact when the market has clearly moved against it, because accepting the loss feels worse than the uncertain possibility of recovery.

The institutional solution to both failure modes is pre-commitment: writing the complete position sizing plan — entry tiers with specific price levels, exit targets with specific percentages to sell at each level, and invalidation criteria with specific conditions for full exit — before the first tranche is deployed, and treating that plan as a contract with oneself rather than a set of guidelines to be adjusted in real time. Pre-commitment research consistently shows that decision quality improves dramatically when decisions are made prospectively in a low-emotion environment rather than reactively in a high-emotion market environment.

Position sizing journals — written records of every entry and exit decision including the reasoning, the planned tiers, and the actual execution — are the single most effective tool for improving position sizing discipline over time. By creating an explicit record of every decision and its rationale, the investor builds a feedback system that identifies which aspects of their framework are working, which psychological failure modes are most recurring, and which market conditions consistently produce the largest deviations between plan and execution.

06 — CONCLUSION: THE COMPLETE POSITION SIZING SYSTEM

The complete position sizing system — combining the entry tier architecture from the first report with the portfolio construction, exit strategy, rebalancing, and psychological discipline frameworks in this report — provides a comprehensive operational infrastructure for crypto investing across the full market cycle. No part of this system is intellectually complex. Every element is implementable by any investor at any portfolio size. The challenge is not understanding the framework — it is applying it with consistency across the full range of market conditions, including the extreme fear of bear market bottoms and the extreme greed of bull market peaks.

The investors who build the most durable crypto wealth across multiple cycles share a characteristic that has nothing to do with superior intelligence or information advantage: they have a written position sizing system that they follow consistently, they review and improve that system after each major market cycle using their position journal, and they have internalized the fundamental asymmetry that defines long-term crypto investing — that the downside of sizing too conservatively is leaving some returns on the table, while the downside of sizing too aggressively is potentially leaving the game entirely.

In Q2 2026 — a bear market phase with genuine uncertainty about cycle timing, macro catalysts, and the evolving institutional dynamics of the ETF era — the investors building and maintaining disciplined position sizing frameworks are doing the most important work available to them. Not researching the next narrative. Not timing the market. Not predicting the Fed. Building the systematic infrastructure that will allow them to deploy capital confidently, hold positions patiently, take profits systematically, and survive the volatility that will inevitably precede the next major opportunity.

> ***The complete position sizing system is not a trading strategy. It is a survival and compounding infrastructure. Build it before you need it. Follow it when you feel like abandoning it. Review and improve it every cycle. That is the entire discipline.***
