TSR TRADING GUIDES

THE THINKING TRADER

GALEN WOODS

The Thinking Trader

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Galen Woods

Contents

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About TSR Trading Guides

The articles in this series of trading guides were first published on Trading Setups Review, where they are available for free reading.

In this series of guides, we have organized selected articles into common trading topics with an exclusive introduction from Galen Woods. The objective is to present a better learning experience for serious readers.

You can find out more about Galen Woods by clicking here.

1. Introduction

Traders should think more than they do.

Most people are not wired to become traders. Enjoying losses, rejecting traditional work ethics, and getting comfortable with fear are just some of the things you must learn as a trader.

To change your mindset into that of a winning trader, you need to gain experience and do some serious pondering.

Keep thinking about what is the right thing to do as a trader. And do it. This is what differentiates a trader from a gambler.

A gambler knows what he is doing is wrong, that he is fighting against the odds, and continues with it. As a trader, you stop doing what's wrong and keep doing what's right. This means that you trade only when the odds favor you.

One of the main theme in this book is to limit your trades. Trading gives the impression of freedom. Traders are free to trade what they want, when they want. Indeed, traders are free to decide how they want to trade. Yet, the key to successful trading is to use this freedom responsibly.

In this book, there are ideas from samurais, philosophers, and professors. Over the years, I've encountered many ideas in life that are useful for traders. This is not surprising as both life and markets are characterized by uncertainty. Good traders learn to be comfortable with uncertainty.

I hope that this book encourages you to look for more parallels between life and trading. As you become a better trader, you will become a better person.

2. Three Lessons For Day Traders From Finance Professors

There is a wide rift between day trading/technical analysis and the academia. It boils down to the efficient market hypothesis which you can read more about here. To many academics, day traders are noise traders, and technical analysis is at best voodoo.

As a result, we don't talk to each other. Day traders stare at their trading charts. Finance professors ramble on in front of college students while trying to get their research into respectable journals. The exchange of ideas is minimal.

However, there are some finance researchers who tried to explore the realm of day trading. We have condensed their rigorous research into 3 top lessons for day traders.

2.1 Emotions Affect The Performance of Day Traders

Fear and Greed in Financial Markets: A Clinical Study of Day-Traders by Andrew W. Lo, Dmitry V. Repin, and Brett N. Steenbarger

I wish there are more studies with this awesome combination of authors: two well-published finance professors from MIT Sloan School of Management and a leading trading psychologist.

Read: The Daily Trading Coach: 101 Lessons for Becoming Your Own Trading Psychologist by Brett N. Steenbarger

This paper studied the survey responses of 80 volunteers from Linda Bradford Raschke's online trading program. It focuses on their emotional responses during the trading process.

The conclusions of this study include:

- Extreme emotions make you earn less
- External factors affect your emotions

We have always heard that managing your emotions is critical for day traders. This study confirms that claim. Day traders who are more emotionally detached from their wins and losses do better than those who react strongly to each trade outcome.

Apparently, Stoics make good day traders.

The paper also pointed out that external factors like the weather, market events, and family history affect an individual's emotional context. This is a reason to be more aware of your emotional response to external events, and know when you should avoid trading.

2.2 Performance of Technical Analysis

The Profitability of Technical Analysis: A Review by Cheol-Ho Park and Scott H. Irwin

This paper is probably the most comprehensive literature review of the profitability of technical analysis. The authors reviewed more than 100 studies on how profitable technical trading rules are.

As most day traders use technical analysis, this paper presents valuable information.

The studies reviewed showed that technical analysis seem to work better in forex and futures markets. In addition, according to survey studies, the use of technical analysis is widespread in forex and futures markets. You might want to consider this when you decide which market to day trade.

Discuss: Why You Should Day Trade Futures

However, the authors pointed out that most performance studies have errors like data snooping. As these studies used mechanical trading rules, this is a stark warning against mechanical trading systems that promises incredibly high win rates.

2.3 Profitability of Day Traders

How many times have you heard that 90% of day traders lose money? Have you wondered if there's any basis to that?

Here's the answer.

Day Trading by Martin Sewell

Martin Sewell from University College London compiled a concise list of studies conducted between 1998 and 2005 on how profitable day traders are. The day traders examined are from US, Taiwan, and Finland.

From those studies, Martin Sewell concluded that 70% to 80% of day traders lose money.

The good news is that 90% overstates the failure rate of day traders. At least according to these studies from different countries around the world.

The bad news is that 70% to 80% is still rather high. To a struggling or aspiring day trader, these numbers are not encouraging. But I don't see why they should be anyway.

The reality is that day trading is challenging. And it is definitely not a way to get rich quick. These studies remind you of this reality.

2.4 The Caveats In These Lessons

These research have definitely offered day traders some basis and perspectives related to many conventional trading wisdom floating around out there.

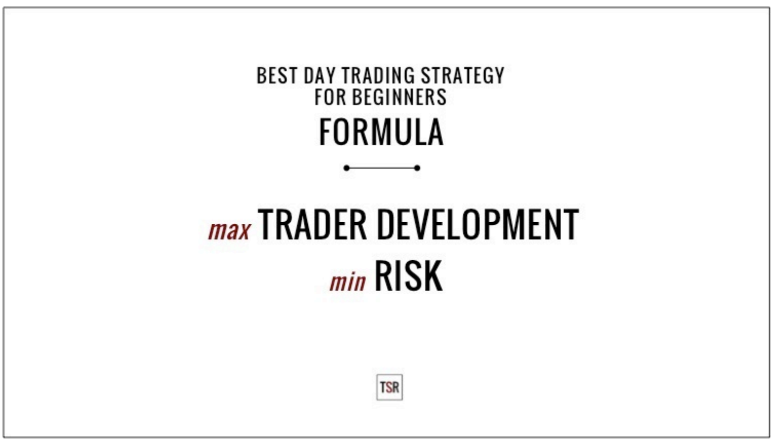
However, absorb them with care. Each study has its own assumptions, samples, methodology. Each conclusion stands only the face of these limitations. Always refer to the original papers for details.

Finally, remember that trading fuses art and science, and not all aspects of trading is quantifiable. Stay open-minded and gain more trading experience to learn to hone your trading gut.

3. The Best Day Trading Strategy For Beginners

What is the best day trading strategy for beginners?

> A day trading strategy that beginners can easily use to make money.
>
> A day trading strategy that beginners can use as a starting point to learn and improve, while minimizing losses.



Best Day Trading Strategy For Beginners

Novice traders should not be driven by profits. Instead, their day trading strategy should focus on **controlling risk** and **developing the trader**.

Day traders who are just starting out should not be led into the glamour of raking profits day after day without first understanding the risks of day trading.

To ensure their longevity in the market, day traders must be able to learn from their trades and develop the right trading attitude.

Look out for day trading strategies with the following characteristics to start your day trading journey right.

3.1 1. Infrequent Day Trades For Beginners

Beginners should trade infrequently. For traders who are still grappling with their trading edge, trading less is definitely better than trading more. It is a form of **risk control**.

Trading infrequently also **gives you time to learn** from your trades. You will also be able to **develop a greater awareness of your emotions** and keep them in check. Taking dozens of trades in a flurry will only cloud your analysis and fuel your feelings of fear and greed. Follow these tips to to trade with a lower frequency.

1. Avoid scalping strategies.
2. Trade higher time frames. (Use 5 minute charts instead of 5 seconds charts)
3. Be very selective and take only the best trades.

3.2 2. Day Trade With The Trend

Day traders love to boast about picking the top of the day or low of the day. When you do catch the top or bottom of the trend, you feel like a hero. When you do not, you feel like a loser trying to fight the trend that seems to go on forever.

Trading is not about heroes and losers. It is about patience and persistence.

A trend trader must be patient and wait for a trend to develop. A trend trader must also be persistent in taking trades with the trend and not be tempted to pick the top or bottom. Trading with the trend helps a beginner focus on the right state of mind necessary for consistent profitability.

3.3 3. Passive Position Management For Day Trading

A novice day trader should set the stop and target for each trade, and leave them alone. **Do not adjust your stops and targets. **

This is because **a beginner is prone to adjusting their stops and targets emotionally**. They make adjustments because they are affected by the blinking profit and loss figure on the screen. Only confident and experienced traders who can manage their trades based on objective analysis should do so.

Rather than meddling with the position when you have neither confidence in your skill nor control of your emotions, leave your stop and target alone. Take out a piece of paper and write down what you would have done if you were managing your position actively. **This is a learning process**.

Once you have a sizeable sample (>30 trades), compare the the results of passive management versus if you had managed it actively. You can then evaluate if you should be actively managing your trades.

This rule of passive management will also **deter a beginner from cancelling the stop loss order**, our ultimate risk control tool.

3.4 Example: Adapting the 9/30 Day Trading Strategy For Beginners

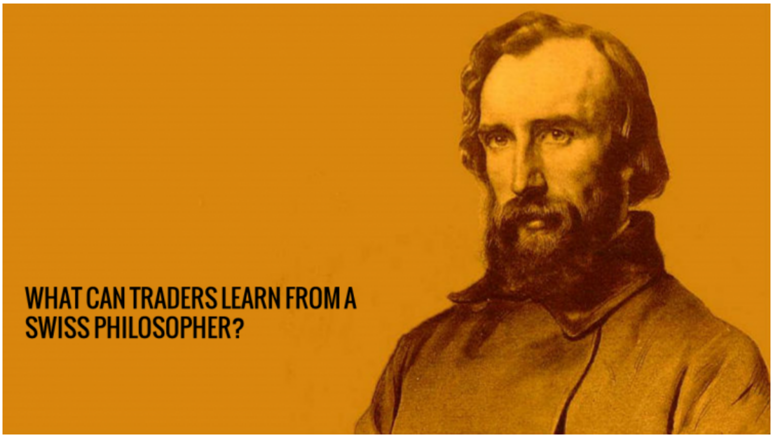
Most day trading strategies can be adapted for beginners. Let's take a look at how we can adapt the 9/30 trading setup for beginners according to the characteristics discussed above.

1. The best trades of 9/30 trade setup are the first pullbacks after a new crossover. We will restrict our day trading strategy to taking only these infrequent best trades.
2. 9/30 trading strategy capitalizes on retracements. Following its rules will naturally keep you with the trend.
3. Place your target at the previous trend high/low and place stop a tick below/above the signal bar. Do not adjust.

There you go, a sound day trading strategy for a beginner. Remember that the best day trading strategy for beginners is not the most profitable trading setup, it is the **best starting point towards success**.

Take a look at our Trading Setups collection for many other day trading strategies that can be adapted for beginners.

4. What Can Traders Learn From A Swiss Philosopher



Lesson for Traders

Henri Frédéric Amiel was born in Geneva in 1821. He philosophized, criticized, wrote poems, and died in 1881.

I do not know much about him, but recently I saw two of his quotes.

These two lines struck me, not only because I agree with them, but also because they are so relevant to trading. I have always observed parallels between life and trading. The lessons I learn about risks and attitudes in trading have molded my outlook in life.

And Henri Frédéric Amiel has summed up two key lessons that apply to trading very well.

4.1 First Lesson For Traders

> The man who insists upon seeing with perfect clearness before he decides, never decides.

Accepting **shades of grey** is necessary in trading. Traders who insist on having absolute rules will never trade well. Trading, like life, is not a game of certainty. It is a game of chance. Until we recognize the probabilistic nature of both trading and life, we cannot move ahead confidently.

This quote also warns us against **analysis paralysis**. Some traders analyze the market using every single tool they can get their hands on. They do so thinking that they can eventually get the perfectly clear picture of where the market is going. They will never get it, and they will never decide. This is analysis paralysis.

4.2 Second Lesson For Traders

> Accept life, and you must accept regret.

This quote highlights this idea of **ex-post regret**. I first came across this concept applied in financial markets in Larry Harris' Trading and Exchanges: Market Microstructure for Practitioners, and Henri Amiel's quote refreshed it.

Basically, it means that regardless of the outcome of your trades, there is always room for regret, due to the way the market works.

Let's say prices hit your limit order at the price target and your trade was profitable. It's good, but the very fact that your limit order was hit, meant that prices went above your target. Since prices went above your target, you could have placed your target higher and earn even more from this trade. You regret not aiming further.

For a losing trade, the ex-post regret is clearer. If prices hit your stop-loss order, it meant that you could have placed a tighter stop-loss and limit your losses. Of course, you might also regret taking the trade in the first place.

Despite the grim reality of inevitable regret, being aware of ex-post regret is extremely useful for traders. If you trade, you must accept regret. Once you accept it, you can move on and exploit your trading edge, and not beating yourself over each trade.

4.3 Conclusion - Henri Frédéric Amiel's Lessons

These are two valuable lessons for traders. They remind us that we decide to trade, despite the shades of grey and the inevitable regret.

In trading and in life, acceptance is progress.

Before we stop here for you to ponder over the learning points, let us thank Henri Frédéric Amiel, who has, across time and space, reminded us of these important lessons.

5. Get Rid of Overtrading Once and For All

Overtrading refers to taking so many trades to the extent that the trader's edge erodes. It is bad for all kinds of traders and even investors. But it is truly a cardinal sin for day traders.

I know this day trader called Hubris. He has always been a profitable trader, or so he claims. Hearing that he is such a wonderful trader, I grabbed the chance to watch him during one of his trading sessions.

> Yes! 2 points in pocket. This is easy.
>
> Let's see… oh, there's another trade over there. I'm shorting right now, just in time.
>
> Ah, lost a point. We'll only get better. See! Right there, there's a chance to recoup my losses.
>
> Sheeeesh, two losses in a row mean that the next trade will be a winner. I must continue.

At the end of the session, Hubris wonders how did he manage to wipe out 30% of his trading account in a single session.

Does Hubris' experience sound familiar? Does it sound like you?

If you answered yes, then you might be able to make vast improvements in your trading performance after reading this article.

5.1 The Root of Overtrading

Unrealistic expectation of market volatility

Day traders need volatility to make a living. When the market is not going anywhere, we should not trade.

However, because of a lack of understanding of the market and the need to trade, traders rationalize and tell themselves that the market is going to move.

Dr. Brett Steenbarger, the author of The Daily Trading Coach: 101 Lessons for Becoming Your Own Trading Psychologist, explained this mismatch of expectations really well on his blog.

Overestimation of trading skills

This is Hubris. He thinks he cannot lose, and is invincible in the market. He might understand the market well, but he does not know himself.

He over-estimates his trading skills and is confident that he can trade in any market condition.

The common work ethic

Our innate work ethic dictates that we must work for income. That is perfectly correct.

What is wrong is the meaning of "work" for traders. Traders tend to think that work means taking trades. That is wrong, and that is what leads to overtrading.

We are working when we are waiting for the best trade.

We are working when we are following our trading rules and executing the trades.

We are working even when we are not taking trades. And if we do our work correctly, we will get paid.

5.2 Fixing Overtrading - The One Bullet Action Plan

The Supreme Rule to Counter Overtrading

The One Bullet Action Plan has just one simple rule.

Take only one trade a day.

No exception. No rationalization.

Take one trade. If it's a winner, shut down your trading terminal. If it's a loser, shut down your trading terminal.

After shutting down your computer, go do something you enjoy. Play with your kids. Read a book. Do something that takes your mind off trading.

Why does it work against overtrading?

As we discussed above, the causes of overtrading are psychological and diverse. They mostly involve our minds playing games with us.

So our solution focuses on physical actions. (Shut down the computer and go play.) Instead of convincing your mind, let's move away physically .

There is only one simple but absolute rule. The more rules there are, the more space for your mind to convince you to take another trade. Having only one absolute rule denies your mind of rationalization.

Are you sure taking one trade a day is a good idea?

Your mind is already trying to rationalize away this supreme rule. So let's get it out of our way.

Knowing that you have only one bullet will force you to take only the best trades. You will be more alert and more selective in your trades. More likely than not, your trading performance will improve.

Taking one good trade a day is enough for your trading edge (if any) to materialize. Assuming you do have a trading edge, how much you can earn depends on the amount of your risk capital.

There is also the problem of undertrading which means that we are not maximizing the full potential of your trading strategy.

Don't worry about that. Far more traders ruin their account because of overtrading compared to undertrading. In fact, no trader has ever lost their trading account by not taking a single trade.

5.3 Conclusion - You must stop overtrading

You **must** stop overtrading because it is a huge obstacle to your trading success.

You must stop overtrading because only you can do it. Although the One Bullet Action Plan works against overtrading, you have to commit to it.

Don't be like Hubris. My other friend, Sophrosyne, is a better trader.

6. How To Increase Your Trading Profits by 3729% And Cut Commissions by 80%

Am I selling a black-box trading system? Or a well-kept break-through technique to turbo-charge your trading profits?

No, you don't have to pay a single cent for this. And there is nothing secretive about what I am going to share.

Some of you might already know what is coming, especially those who have kept excellent records of their trading activities.

This money-saving (and money-making) idea works with most trading strategies.

6.1 Case Study: Trend Bar Failure Strategy

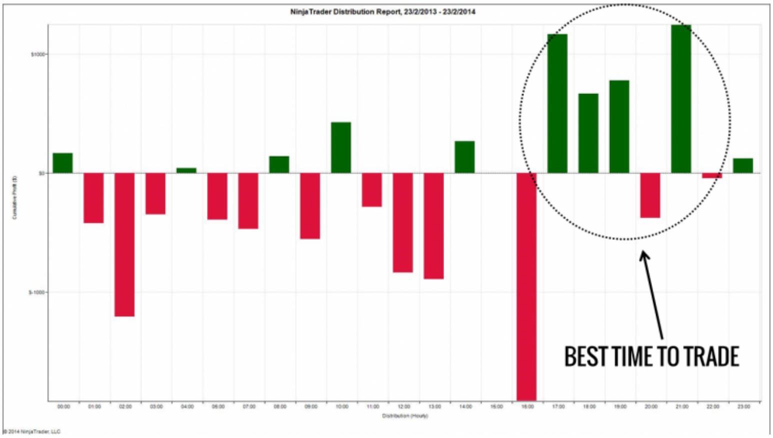
In this example , we will use the Trend Bar Failure setup.

Strategy Back-test

- Instrument: 6E futures (EUR/USD)
- Time-frame: 1-hour
- Period: 23/2/2013 to 23/2/2014
- Stop-loss: Pattern stop
- Target: Average hourly range x 2

With these parameters, we lost $62.40 trading one contract per trade. But that is not the point.

This is:



Trading Profits Distribution Graph by Time

The three most profitable hours are within a five-hour period.

What do we do with this information?

Let's re-run the back-test. This time, we will be lazy and trade only during the five-hour period.

The table below compares the two sets of trading results.

	Trading Round The Clock	Trading Between 0900 GMT And 1400 GMT	% Change
Number of Trades	110	23	-79.09%
Comissions	$587.40	$122.82	**-79.09%**
Net Profit	($62.40)	$2,264.68	**3729.29%**

Improvement in Trading Results When You Restrict Trading Hours

By restricting our trading hours and settling for less action, we have managed to:

- Decrease our commissions by 80%
- Increase our trading profits by 3729%

Do you want to pay $62.40 to take 110 trades? Or do you prefer to take 23 trades and make $2,264.68?

This case study is not about trading Trend Bar Failures using a mechanical approach. If you want to learn more about this simple price action trading strategy, you should refer to this article.

The real takeaway here is the impact your trading hours has on your trading profits.

6.2 More Trading Profits For Trading Less

Trading less is more, if you know when to trade.

We can earn more if we know which are the best hours to trade and stick with them.

The best hours to trade depends on many factors including the market you are trading, your trading time-frame, and your trading strategy.

As a rule of thumb, most active trading strategies do better during higher volatility periods.

Back-test your trading strategy like what we did above to gain insights on which are the profitable hours. If you trade with a discretionary strategy and find it hard to back-test mechanically, you can do manual back-testing.

However, manual back-testing is tedious and has greater room for error. So, if you have kept good records of your trades, you can put them to use now. Check your trading records to see if your profitable trades tend to cluster within a certain time period each day. Go through the day trading evaluation cycle and find when to take the best trades.

Examine your trades and you might uncover when you should trade to maximize your trading profits. It is time to forget about taking as many trades as you can. Trade only when it matters.

Take a closer look at your trading records now and uncover this hidden gem in plain sight.

You might realize that trading the first two hours of each trading session makes you more money than trading the entire session. On top of that, you get to free your time from trading and spend them with your loved ones.

7. Looking For The Perfect Trading Setup?

Are you still looking for the perfect trading setup? Are you still caught up in this endless cycle?

1. Find a **new trading setup** and trade it.
2. Get a series of **winning trades** and declare that you have found the Holy Grail, the perfect trading setup.
3. Suffer a (longer) series of **losing trades** using the same trading setup.
4. **Condemn** the trading setup and **google for the next**. (Back to step 1)

For most traders, the search for the perfect trading setup will never end. But the sooner you end it, the nearer you are to consistent profits.

The first step: **Recognize why you should stop looking**.

7.1 Who Will Give You A Perfect Trade Setup?

A perfect and foolproof trading setup is like a cash generating machine. It gives you guaranteed profits.

And all you have to do is to click the buy and sell buttons at the right time. Absolutely no hard work involved.

Just click along and I'll see you on the next round-the-world luxury cruise.

Sounds too good to be true?

It is.

Anyone promising you a cash generating machine is lying. **Stop looking for it**.

7.2 A Trading Setup Is Part Of A Winning Trading Plan.

"Fool + Foolproof Trading Setup = Winning Trading Plan"

Perfect Trading Setup

A trading setup, in isolation, will never make you profitable. You need to follow the rules and judge the price action context. You need to control your emotions and manage the trades. You must not be tempted to risk too much on a single trade.

The point is you need a lot more than a trading setup in a trading plan that wins.

7.3 The Only Perfect Trading Setup

The only perfect trading setup is one that is consistent with the other moving parts.

Trading Market and Context

You must find the right market and context for the trading setups. For instance, use the Holy Grail in trending markets and the Bollinger Squeeze in a quiet market poised for breakout.

With experience, you will learn what is the correct context to employ each trade setup.

Trading and Personality

The trading setup must be compatible with your personality. If you are not comfortable making buy and sell decisions in a split second, you cannot use a scalping strategy. If you cannot withstand long drawdowns, you cannot trade trend-following strategies that sacrifice win rate for the occasional home runs.

Trading Capital and Time

The trading setup must be given enough time and trading capital to prove itself. It is not wrong to change our trading setups, but we must have good reasons for doing so.

We must also have enough money in our trading account to trade the setup effectively. By back-testing, **find out the maximum drawdown** and make sure your trading account has more than enough money to handle that.

Trading Size Sample

Trading is a game of probabilities. It is simply irrational to judge a trade setup with a single trade. Take between 20 to 30 trades before evaluating the setup. Maintain meticulous records for these trades so that you can find ways to improve it.

Start: 6 Steps to Find A Day Trading Strategy That Works

A trading setup that is consistent with your trading plan is your perfect trading setup.

The market is not for trading setups junkies. We want to help you find your trading setup, in the right way.

8. How Profitable Is Losing Money?

Very profitable. That's right. For traders, losing money is very profitable. In fact, if you cannot lose money, you cannot earn any.

If that sounds like a paradox to you, you need to stop trading until you resolve that.

8.1 The More You Lose, The More You Earn

In our example, we will assume a trading system with 50% win rate. For simplicity, you earn $200 if you win and lose $100 otherwise.

This table shows 30 simulated trades.

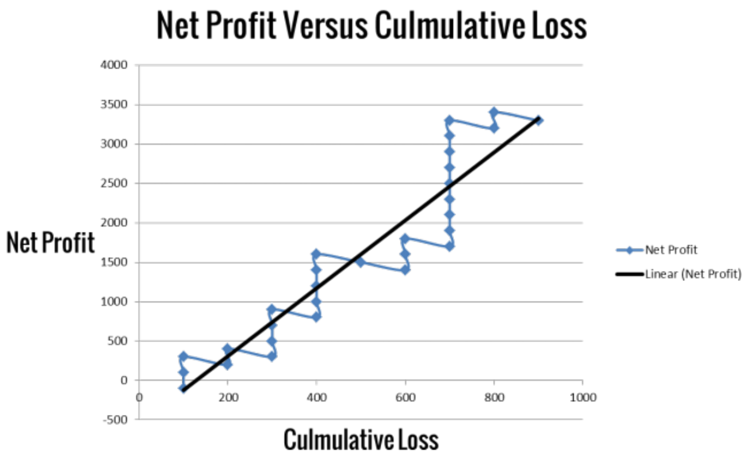
Trade No.	Profit	Loss	Cumulative Profit	Cumulative Loss	Net Profit
1	0	-100	0	100	-100
2	200	0	200	100	100
3	200	0	400	100	300
4	0	-100	400	200	200
5	200	0	600	200	400
6	0	-100	600	300	300
7	200	0	800	300	500
8	200	0	1000	300	700
9	200	0	1200	300	900
10	0	-100	1200	400	800
11	200	0	1400	400	1000
12	200	0	1600	400	1200
13	200	0	1800	400	1400
14	200	0	2000	400	1600
15	0	-100	2000	500	1500
16	0	-100	2000	600	1400
17	200	0	2200	600	1600
18	200	0	2400	600	1800
19	0	-100	2400	700	1700
20	200	0	2600	700	1900
21	200	0	2800	700	2100
22	200	0	3000	700	2300
23	200	0	3200	700	2500
24	200	0	3400	700	2700
25	200	0	3600	700	2900
26	200	0	3800	700	3100
27	200	0	4000	700	3300
28	0	-100	4000	800	3200
29	200	0	4200	800	3400
30	0	-100	4200	900	3300

Simulated Trades For Losing

Other than the profit and loss per trade, the table also shows the cumulative profit and loss amount. The difference between them is the net profit.

We highlighted the cells in yellow when cumulative loss increases. What do you notice?

Do you earn more as you lose more?



Profit versus Loss Chart

This graph shows clearly that net profit increases with your cumulative loss. In other words, you need to lose to make more.

This positive relationship between net profit and cumulative loss is true for a **large sample of trades that follow a trading method with positive expectancy**.

Expectancy

Expectancy is the difference between two products with your win rate. The formula is:

(Odds of Winning x Average Win Amount) - (Odds of Losing x Average Loss Amount)

In our example, the trading system's expectancy is (0.5 x 200) - (0.5 x 100) = 50. It has positive expectancy.

Essentially, to trade profitably is a simple two-step process.

1. Learn a trading method with positive expectancy
2. Love your losses

8.2 A Business Mindset for Trading

Let's drill in the same idea from a business perspective. Trading is a business and it pays to remember that.

Imagine that you own a brick-and-mortar business of selling computers. How do you make money? You sell computers for a profit.

However, we cannot sell computers without buying them in the first place. We need to buy computers and incur a cost. That is the cost of doing business and making money.

For a trading business, losing trades are the cost of business. You must buy computers to sell them for a profit. You must have losing trades so that you can have winning trades.

The only way to avoid any loss is not to trade at all. No risk, no profit.

Given the probabilistic nature of trading, losses are not only inevitable, they are necessary for trading profitably. Once you appreciate this, you will start to take your losses gracefully and avoid destructive behavior in your trading.

8.3 Risk of Ruin

There is one key exception to the principle of "lose more, earn more". **You must not lose so much that you risk ruining your account**.

A trading account is ruined when you can no longer trade with it. It means that you can no longer afford to open the smallest possible position in the market that you trade. For instance, your day trading margin for ES futures is $500. If your account falls below $500, it is ruined as you cannot post margin for even a single contract.

As losses are inevitable even in the best trading strategy, your trading account will experience drawdowns. Watch your losses and make sure that they do not ruin your account.

The moral of this exception is: Take losses happily but avoid risk of ruin.

Avoiding risk of ruin is a matter of applying money management models to control your trading size and having the discipline to follow them.

Read: A Trader's Money Management System: How to Ensure Profit and Avoid the Risk of Ruin (Wiley Trading)

8.4 Conclusion: Profitable Traders Love Losing Money

Recognizing the true nature of losses in a profitable trading system is extremely helpful for struggling traders.

Realize that losses make you rich if you:

- Have a trading edge
- Are disciplined
- Apply the right position sizing model

Get these factors in place and you will enjoy losing (and the profits that come with it).

9. Take Only The Best Day Trading Setups

Taking the best day trading setups will make you the best day trader.

Many people think of day trading as moving in and out of the market rapidly, and making daily profits. That is what brokers would like you to believe, because they earn a commission for each trade you make.

The reality is different.

9.1 Slow Down Your Trading

If day trading is only about trading rapidly throughout the day, then it is not a game for retail traders like us. Because we are slow (very very slow) compared to these guys.

Let's slow down so that we can put the odds back in our favor.

9.2 Day Traders Have Plenty of Trade Opportunities

There are ample day trading setups each day. But this is a **double-edged sword** for day traders.

Pros of Ample Day Trading Setups

- Learn more in a shorter time frame.
- Grow our trading account at a faster rate. Daily compounding leads to astronomical figures.
- Be more selective and take only the best day trading setups.

Cons of Ample Day Trading Setups

- Not enough time to check and learn from our trades.
- Lose our shirts within the day.
- Over-trade. Over-trading is not merely taking many trades. Over-trading means trading so frantically that you ignore your trading edge. It is one of the worst sins of traders and many day traders blow out their account because of over-trading.

Learn: How to Stop Over-Trading

9.3 Take Only The Best Day Trading Setups

This is the only way to avoid all the cons, and go for the pros.

By taking only the best day trading setups, you will have more time to review your trades, and still gain experience faster than most traders. You will avoid over-trading and keep up your trading edge.

Think of taking the best trading setups as a luxury only available to day traders.

Position traders might need to wait for weeks before having a trading opportunity. They must take every trade that comes along for fear that the next trade will only come weeks later.

Taking only the best trades is not an option for them.

Taking only the best day trading setups

9.4 How To Identify The Best Day Trading Setups?

First, learn your trading setup well and understand the market conditions for it to work. Burn the rules for buying and selling into your head.

Next, while evaluating each trading setup, ask yourself this: **Are there any reasons not to take this trade?**

These are some reasons that might make you reconsider taking that trade.

- Prices are stuck in a tight trading range (series of dojis) in which price action is wild and unpredictable.
- The signal bar closed against your market bias.

- There are major support/resistance between your signal bar and your target price.
- A trend climax took place before your pullback trade. (A sign of trend exhaustion.)
- The signal bar has an abnormally large range which increases your risk, and might show exhaustion.

If you cannot find any reason not to take that trade, then that is the best trade.

Understanding the concept behind your trading setup will also help you find the best trades.

For instance, the Hikkake candlestick pattern profits from trapped traders. Naturally, the best Hikkake setups are those with the most number of traders trapped.

Learn: Day Trading Evaluation Cycle

Last but not least, while we aim to take the best day trading setups, we must not fall into paralysis. Act on the trades that are too good to resist.

10. Trading the Markets like a Samurai

The modern world may no longer have room for samurais pledging their loyalty to feudal daimyos. But the discipline and focus of samurais may still have a place in helping us trade better.

This article is inspired by this list of samurai quotes I stumbled upon. It has 12 quotes from the legendary Japanese swordsman, Miyamoto Musashi. It is amazing how these gems from an ancient warrior code are so relevant for trading the markets.

10.1 Control Your Trading Emotions

> When your opponent is hurrying recklessly, you must act contrarily and keep calm. You must not be influenced by the opponent.

As traders, who is our opponent?

Other traders. Or more accurately, their collective actions and the resultant market action.

The market rose quickly. The unprepared trader, afraid of missing out on the next big move, chased the market. After the dust has settled, he found himself holding a long position at the high of a market poised to fall.

To avoid such uncomfortable and unprofitable positions, do not be influenced by the market. When the market is euphoric, stay calm. Do not be pushed into taking positions. You are certainly not in control of the market, but never let the market control you.

10.2 Hone Your Trading Instinct

> Perceive that which cannot be seen with the eye.

When we lay our eyes on a chart, we see all sorts of visual depiction of the market like candlesticks, chart patterns, and bar patterns. However, unless you trade with rigid rules, your trading edge stems from something beyond the visuals.

This is the crux of discretionary trading. All discretionary traders agree that our minds perceive something that we cannot quantify exactly. And that something is the source of our trading edge. (If you think otherwise, then you should learn how to program mechanical trading systems.)

Thus, in a matter of time, you must start to feel the market and develop your trading gut. But do not use your trading gut as an excuse to trade with your emotions. While you need not have rigid trading rules, you should have valid reasons for taking each trade.

10.3 Focus on Your Trading Objective

> The only reason a warrior is alive is to fight, and the only reason a warrior fights is to win.

The only reason we analyse the market is to trade, and the only reason we trade is to win. The latter clause is the key to trading consistently.

The reason we trade is to win. Traders often forget this seemingly obvious aim.

At times, we want something else more than we want to win. At times, we want to trade because we want to make up for earlier losses more than we want to win. At times, we want to trade because we want to prove to our peers that we can make money more than we want to win. Each time we forget that what we want is to win, we ignore our trading rules and take rogue trades.

We know that we have a winning trading plan. Yet, we do not follow it. Why?

The only explanation is because we do not want to win, or rather we forget that we want to win. Hence, to trade well, we must remember that we want to win. (The art of reminding ourselves that we want to win is called trading psychology.)

10.4 Deal with Losing Trades

> Do not regret what is done.

How many times have you regretted taking a trade? How many times have those feelings of remorse helped you trade better?

In the mind of a consistent trader, there is no place for regret.

If we took a trade that was consistent with our trading plan, regardless of its outcome, we should not regret taking it. We expect a large sample of good trades to be profitable. But we should not expect every good trade to be profitable. Thus, if you regret each losing trade, then you have not understood the probabilistic nature of trading.

If we took a trade that was inconsistent with our trading plan, there is no need for regret as well. Recognise the mistake and look ahead. Seize the next trading opportunity as a chance to right the wrong. Regret and dwelling on your losses lead to revenge trading which will ruin your trading account.

10.5 Respect the Market

> Like a sword, a word can wound or kill, but as long as one does not touch the blade, the sword is no more

> than a smooth piece of metal. Someone who knows the qualities of a sword does not play with it, and someone who knows the nature of words does not play with them.

And someone who knows the nature of the market does not play with it. If you understand the nature of the market, you will learn to respect it including the risks and uncertainty it brings.

Trading is not a trivial endeavour. It is not game. It is a challenging job and a serious business. Hence, if you are playing with the market, then you have not understood it. You should treat trading as a business or not trade at all.

Print these quotes out and paste them on your trading desk.

Start your journey as a market samurai today!

Want to learn more from Miyamoto Musashi? Take a look at his book on the way of samurai - “The Book of Five Rings”.

11. Using Fear to Boost Your Trading Performance

Are you fearful when you trade? Or are you fearless when you trade? What is the link between your fright and your trading performance?

“Fear” is often stated as one of the twin emotions that plague traders together with “Greed”. In fact, as long as this pair psycho-brothers are around, market behaviour will never change. It will always move in cycles of boom and bust.

In that case, emotions are bad for trading performance, right?

Not really.

11.1 Market Fear Powers Profits

The fear and greed wreaking havoc among traders and investors is the source of profitable trading setups. If the market is not affected by emotions and its related cognitive biases, the market will be a lot more efficient. It will be a lot harder to make money. (One of the key assumptions in the efficient market hypothesis is that its participants are rational.)

Since we aim to make money from the market, we should rejoice that the market is an emotional one.

Okay, I understand that if the market is emotional, I get more trading opportunities. But I should stay without emotions to make full use of these opportunities, right?

Again, not true.

11.2 A Healthy Dose of Fear for Trading Better

Fear is a natural protective mechanism. We cannot and should not turn it off.

Humans always experience fear. Some traders think that by using automated trading systems, they are able to trade without fear. This is not true. These traders can turn off or change their trading systems if they want to. Thus, a trader using automated systems must still make sure that his decision to interfere with the trading system is not driven by fear.

Even if we can mute our feelings of fear, we should not.

Fearless is not the Answer

Only a trader who does not understand the market can be fearless in it. There is every reason to fear the market. The market is beyond the control of anyone, and is largely unpredictable. It has the potential to ruin entire economies, not to mention your retirement nest egg.

When trading the markets, it pays to have a healthy dose of fear.

Response to Fear is the Key

There is another reason why getting rid of fear is not our concern. Fear is not the root of our trading woes like lack of discipline or over-trading. It is our response to fear that screws things up.

It is fine to be afraid that your next trade will be a losing one. But when you react destructively to it, you have a problem. You react to your fear of a losing trade, and start to ignore your trading rules. You cut your profits short or tighten your stop-loss prematurely. Such reactions will decrease your profits in the long run.

Instead of reacting destructively when you feel scared, try to respond constructively. Think of why you feel fearful? Perhaps your position size is too big for the size of your trading account?

Then, the correct response is to take a smaller position. In this case, our fear alerted us to the danger of trading a large position, and we have responded to cut that risk.

Excel with Fear

The best traders move beyond that. They recognise fear in the market and capitalise on it to make money. For instance, they find price points where there would be an exodus of frightened trapped traders. Then, they take advantage of the order flow they create and profit from them using price action trading setups.

To do so, they cannot be emotionless themselves. They must also experience fear, before they can learn to recognise it in others. The difference is that rather than reacting to their fear destructively, they turn it to their advantage.

11.3 Embrace Fear To Boost Trading Performance

Understand that fear:

- creates profitable market inefficiencies,
- highlights danger in our trading activities, and
- pinpoints trading setups.

It is time to change our opinion about fear and embrace its benefits.

Want concrete steps to improve your trading psychology?

I recommend Brett N. Steenbarger's The Daily Trading Coach: 101 Lessons for Becoming Your Own Trading Psychologist