



# STOCKMARKET MASTERY

Your Trading Club Online Course  
Module 10





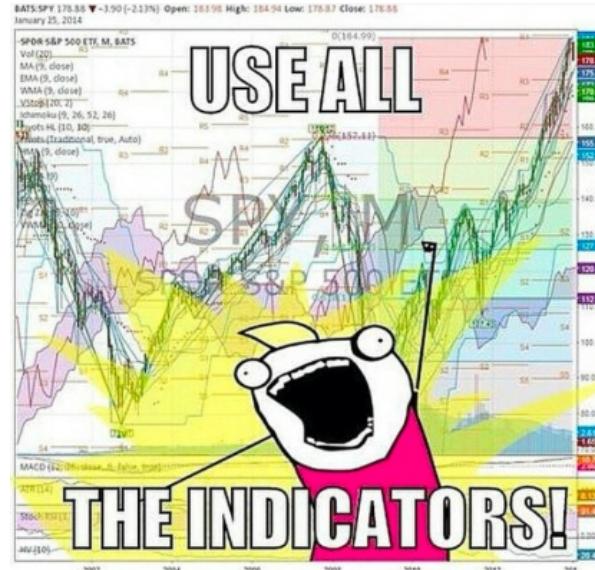


## Module 10 – Analysis paralysis

Dennis Sahlström



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## Module 10 – Confirmation bias and marrying the trade

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### What is Confirmation bias

- Confirmation bias affects perceptions and decision-making in all aspects of life, but it can create problems for traders.
- Confirmation bias is when you start with a hypothesis and then look for things that confirm it.
- When analysing a chart, traders develop an idea about a particular instrument and its eventual direction. But, it means that we can often see patterns where they do not exist.

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Confirmation bias can lead to poor trading decisions, such as the direction and timing of trades

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## How does confirmation bias negatively impact you and your portfolio

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- **Missing Opportunities** - Confirmation bias encourages traders to remain preoccupied with their own prejudices and stay in their comfort zones. As a result, they might easily miss one or multiple opportunities because they have **married the trade idea** they currently have.
- **Holding onto Trades** - Greed can take over when we are in winning positions, and our confirmation bias can have us extend the target we originally had for our trade idea.

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## How can you Avoid Letting Confirmation Bias impact your trading?



- **Developing an alternative trade idea** involves thinking of potential drawbacks with the existing trade idea, making a list of different potential outcomes, and building an alternative investment case to collect and interpret data objectively.
- **Accountability is key** for critical thinking and avoiding confirmation bias, and having a trading buddy or joining a like-minded community can help provide an objective view

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Having a capital management system in place is important, as it allows traders to determine how much capital to risk on each trade.

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## Module 10 – Loss Aversion or Trading Scared

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### What is Loss Aversion or Trading Scared

- **Loss aversion** and **trading scared** is the tendency of a trader to avoid losing more than trying to profit
- Loss aversion is a natural human tendency that can have a negative impact on trading accounts if not managed properly
- Loss can be an emotional challenge for many people, particularly investors and traders, but some may struggle with it more than others

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## How does Loss Aversion and Trading Scared negatively impact your portfolio



- **Loss aversion**, like **confirmation bias**, can cause huge pressure not to sell, or to cling onto a trade that is going against you. Because you're so focused on not incurring a loss, you might start thinking that the trade will improve and eventually move in your favour – a behaviour that has more often than not hurt traders badly.
- Furthermore, a trader that is letting this bias get the better of them can also engage in the following behaviour: **taking profit too early!** Since the prospect of losing money is so intense, traders can tend to take profit as soon as they see it, rather than **letting their profits run!**
- As a matter of fact, loss aversion causes you to deviate from your initial trading strategy.

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## How can you overcome Loss Aversion and Trading Scared?



- **Losing is part of the game** - First, keep in mind that a good trader needs **volatility and risk**. Without these two, trading would not exist. Therefore, losing is just a part of the plan. Once you master this psychological trap, you will be able to cope with most trading situations.
- **Know your system!** – Having a comprehensive understanding about your strategy and its performance is critical. Being armed with stats like **win rate, average risk-to-reward ratio, average losing streak, average win streak** etc.

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## Module 10 – What is revenge trading

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## Revenge trading

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What could have been a one-time loss eventually becomes a drastically depleted trading account or the dreaded margin call

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Revenge trading and its negative impact on you and your portfolio

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## How can you avoid revenge trading/overtrading



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- Understand and accept that losses are unavoidable
- Only take trades that meet the rules of your strategy
- Put systems in place to make sure you only take strategy-based opportunities

- When you have lost 2 trades for the day, stop trading for the day. Every day is a new opportunity!
- Use breathing techniques. After losing, take 10 deep breaths and go for a walk before you get back so you can get back to your senses.
- Take responsibility. The market owes you nothing and does not know you exist!



## Module 10 – What is trading psychology

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## Trading psychology

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Trading psychology refers to the emotions and mental state that can impact our decision making when trading and investing

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- Trading psychology can be explained and understood by analysing the role of two specific **emotions** and **behaviours** that are the underlying drivers of poor decision making by traders and investors
- We are, of course, talking about **FEAR** and **GREED** mostly
- But other emotions like anger, frustration and regret can also influence a trader

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## Understanding the role of greed in trading and investing

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- Greed can be thought of as an excessive desire for more, so excessive that it can cloud rationality and judgment
- Therefore, greed-inspired trading and investing can lead traders towards a variety of suboptimal behaviours

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## Understanding the role of fear

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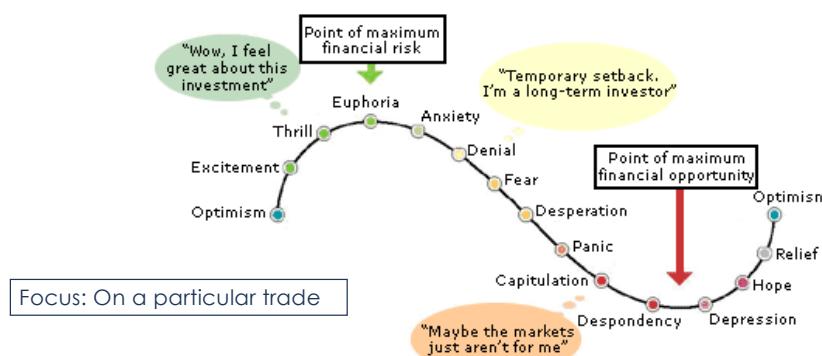
- Fear causes traders to close out positions prematurely or to refrain from taking on risk because of concern about losses
- Furthermore, when an investor sees their investment is going against them for a sustained period, investors can become fearful of further losses, so they sell

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- You are the final decision-maker for your portfolio and, thus, responsible for any gains or losses in your investments
- Profitable traders and investors base their decisions of how to engage in the market on a strategy, or a set of rules that have been proven to yield consistent profitable opportunities while keep the risk low and the reward multiple times greater than the risk
- This helps them to not let their emotions dictate how they engage in the market

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## Typical emotion cycle with no rules



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## The IM emotion cycle with rules

At the start of your trading cycle, you will go through the same steps as the people who do not have trading rules



Focus: On your trading account

This is the turning point where most people accept defeat. This is where YOU start understanding etc.

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