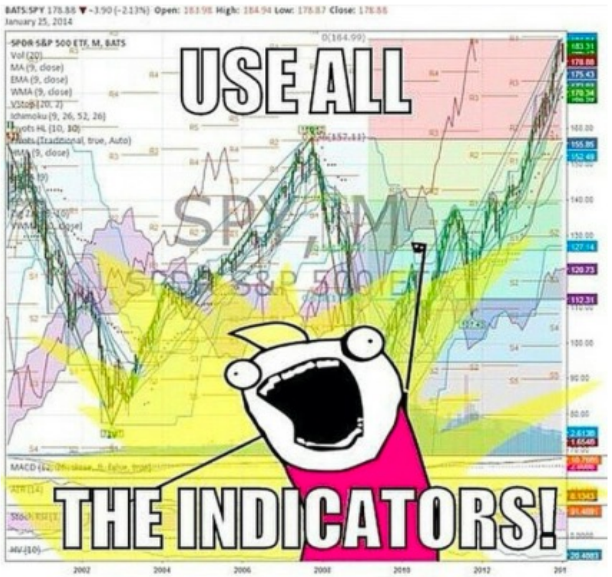
STOCKMARKET MASTERY

Your Trading Club Online Course

Analysis paralysis

Dennis Sahlström

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Stride, Inc., 1D, NYSE O35.08 H35.81 L34.80 C35.76 +0.61 (+1.74%)
Vol 496.642K
USD
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43.00
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Confirmation bias and marrying the trade

Dennis Sahlström

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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.

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

How does confirmation bias negatively impact you and your portfolio

- **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.

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

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

Loss Aversion or Trading Scared

Dennis Sahlström

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

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.

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.

What is revenge trading

Dennis Sahlström

Revenge trading

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

Revenge trading and its negative impact on you and your portfolio

How can you avoid revenge trading/overtrading

- 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!

What is trading psychology

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Trading psychology

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

- 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

Understanding the role of greed in trading and investing

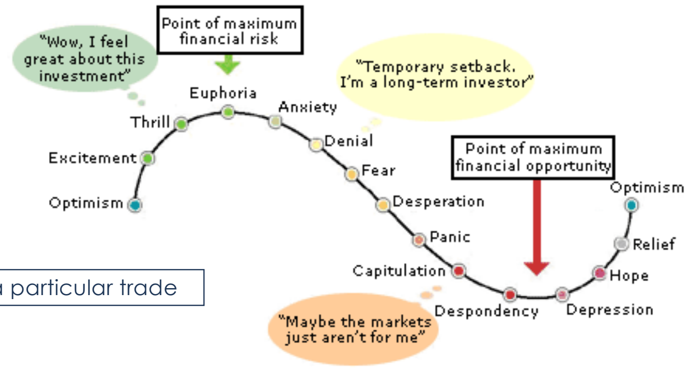
- Greed can be thought of as an excessive desire for more, so excessive that it can cloud rationality and judgment
- Therefore, greed-inspired trading and investing can lead traders towards a variety of suboptimal behaviours

Understanding the role of fear

- 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

- 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 the engage in the market

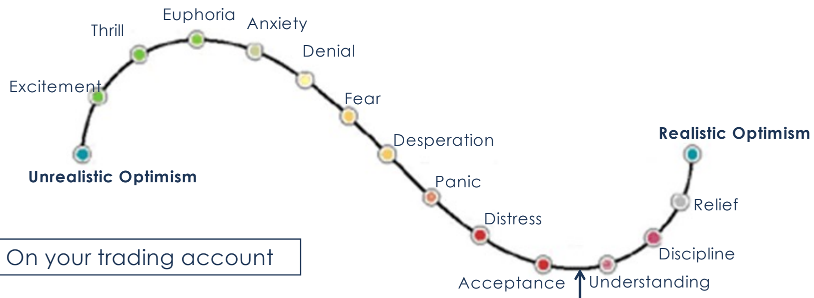
Typical emotion cycle with no rules



Focus: On a particular trade

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.