WHY EMOTIONS

MESS WITH YOUR TRADING

Tradeciety
Your Daily Dose Of Trading Tips

The ultimate guide to understanding your psychology as a trader

By Tradeciety.com

Contents – What you need to know about trading psychology

Trading psychology and why traders screw up

Just take a look at your last 50 trades and think how your performance would look like if you hadn't done all those emotionally caused trading mistakes. My guess is that you would be a much better trader if you could control the psychological side of trading a bit better.

In this ebook we compiled the most problematic emotionally caused trading problems, how they manifest in your daily life as a trader and what you can do about it to counter the impacts of bad trading behavior and impulsive trading mistakes.

1. The 6 most common trading emotions

Fear

"Instead of hoping he must fear; instead of fearing he must hope." - Livermore

Fear is one of the two most frequently talked about emotions in trading (greed, which comes next, is the other one). Fear manifest itself in a number of ways in trading and it can be the cause of many trading mistakes.

The fear of losing lets traders delay the realization of a loss, which then turns into much greater losses, and the fear of giving back profits which make traders close winning trades too early. There are many facets of fear in trading as we will see later on.

Greed

"The point is ladies and gentlemen that greed, for lack of a better word, is good." – Gordon Gekko

Greed is supposed to be good, but when we look at the hard facts, greed often causes a number of impulsive trading decisions that should be avoided.

Traders who are influenced by greed often don't adhere to sound risk and money management principles. Greed also reinforces the gambling mindset which describes trading without set rules and based on impulsive decisions.

Hope

Hope, fear and greed often come hand in hand. Traders who are in a losing position often show signs of hope, when they delay the realization of a loss and give a trade more room to breathe. Another example of hope is when traders try to make up for past losses and then enter a trade with a position that is too big and not according to their rules.

Excitement / Anxious

Any touch of arousal when trading is a sign that somewhere along the lines, you went wrong. When you are overly anxious when you are in a trade, it is often a sign that your position is too big, you broke your rules or that you shouldn't be in that trade.

Keeping track of your arousal level and asking yourself why you feel anxious or excited can often help you get out of trades where you shouldn't be in the first place.

Boredom

Although boredom is more a current state than an emotion, it is worth pointing it out. Traders who are bored also often lack focus. A sign that you lack focus is when you find yourself going through the same instruments and time-frames over and over again without really knowing what you are looking for. Also, when you miss trade entries, because you weren't paying attention, browsing the internet or doing something else is a sign that your focus is not where it should be.

Get your priorities straight and when you are trading, don't engage in any other activities.

Frustration

Frustration is often the cause of trading mistakes that result from any of the previously mentioned emotions. When traders miss trades, violate their rules and lose money, take too much risk and lose too much money, or see what they should have done, frustration starts to take over. Frustration then reinforces all the bad negative behavior patterns that a trader struggles with anyways and intensifies the problems a trader has.

2. Reading emotions from your trading decisions

"The best trading system is worth nothing if you can't handle your emotions.

It does not matter whether you are reading sophisticated trading books or just browse around online trading forums, almost every trader seems to be aware of the fact that psychology has a big impact on trading performance. However, the way emotions affect trading decisions are very complex and not that obvious at the first glance.

When you think that biting nails, sweating or rubbing your hands greedily are the things that signal emotions while trading, this article will offer some valuable new insights. In the following we explain how to read emotions that affect your trading decisions and how to overcome the negative impacts that arise from emotion caused trading errors.

"I missed the trade although it had all the entry criteria."

Especially inexperienced traders or traders who find themselves in losing streaks often act like a stunned deer staring motionlessly into approaching headlights. The surest sign that fear is controlling your trading decisions is that even though you plan a trade and watch the setup unfold in front of you, you still doubt the trade and cannot pull the trigger.

If you notice that you constantly miss trades, although they meet all your entry criteria, you should decrease your risk. Eliminating the possibility to risk a substantial amount of money will usually help decrease the impact of fear-based trading errors. After you have gained confidence and trust your trading strategy you can slowly increase trade size until you find your threshold. Printing out your trading rules and checking them off one by one can also help with eliminating fear of entering trades.

"How could I have lost so much on this trade? It looked so good."

The opposite effect will come into play if you find yourself losing disproportional large sums on individual trades. If you overestimate the predictive quality of your trading system, you are more likely to use a bigger than usual position and blank out the fact that trades will fail. Furthermore, traders who have a small trading account are more likely to risk a relatively large percentage on individual trades to grow trading accounts quickly. The dominant emotions in these scenarios are greed mixed with overconfidence and ignorance - a deadly combination.

The best thing you can do is to reduce trade size to avoid large drawdowns. You should set an absolute maximum risk level that you will not cross - no matter how good you think a setup is.

"I think it's going to turn around. I just widened my stop loss order a bit. It is a good setup."

This sentence is a continuation of the previous case. When traders believe that a setup is too good to fail, they are more likely to find reasons to avoid realizing losses by widening stop loss orders, adding to losers or completely taking off stops.

When you find yourself in a similar position, you are trading based on hope and ignorance. At this point you have already completely forgotten your trading plan and the only reason why you are still in the trade is because you hope that it will turn and you don't have to take a loss. If you ever find yourself in this situation, immediately close your trade to be able to neutrally evaluate the situation.

"The trade looked so good. I thought it would move further and not turn around that quickly."

A sure sign that greed is influencing your trading decisions is when you do not take profits, even though the price has already reached your take profit level. Although you might be able to get a bigger winner every now and then, what really happens is that you will constantly give back profits and cut your winners. Over the long term this can even turn a good trading system into a losing one.

Always stick to the plan you made before you entered the trade. Don't listen to the greedy voice in your head that pops up once you are in a trade.

"The trade has already made some good profits. Maybe I better close it before it turns around again."

This is the opposite scenario to the previous one. Whereas greedy traders will not realize profits because they hope to get more, fearful traders close trades which are in profits ahead of their take profit order because they fear that markets can turn any second.

There are several ways to overcome the premature closing of trades based on fear. The set-and-forget approach, where you close your chart after you opened the trade and set stop loss and take profit order might work well for some trading strategies. Don't watch your P&L during trades because you will start worrying about every down-tick. Gain trust in your trading strategy over time and accept the fact that price moves in waves - retracements are, therefore, normal and should not be mistaken with reversals.

"It doesn't have all the entry criteria just yet, but I still enter the trade now. I will not let this take off without me this time."

"FOMO = The fear of missing out."

Entering trades too early because you worry that you could miss a trade is another sign that greed is messing around with you. Your trading rules serve as a filter and their only purpose is to keep you out of those trades that have lower likelihood of turning into winning trades. Therefore, if you violate trading rules with the expectation to outsmart the market, you misunderstood the way trading works and are a victim of your greed responses.

Hindsight Can Affect Your Emotional State

Emotions do not only play an important role while you are in a trade, but they can impact your emotional state and future trading decisions even after you have closed your positions.

"Oh, I exited too early and should have let it run - next time I will set my take profit further away."

If you see that, after you closed your trade, price would have further moved in your favor, you are more likely to set wider take profit orders on the next trade. Setting wider take profit orders, without statistically validating that it will have a positive effect on your trading performance, can be a very dangerous thing to do. Usually, just randomly using wider take profit orders will only result in a lower winrate because price will turn ahead of your take profit order.

Traders who have a problem with greed based trading decisions are more prone to look back at trades and punish themselves for not letting it run longer.

"I knew it! I felt it was going up, even without meeting all my entry criteria. I should be more aggressive."

Another problem that arises from hindsight knowledge is when traders see that a trade would have worked out even though not all entry criteria had been met, they are more likely to violate trading rules on their next trades.

How to deal with hindsight knowledge

Hindsight knowledge is a very important thing in trading, especially when it comes to making improvements to your trading strategy and tweaking your edge, but the way traders use hindsight is completely wrong. Here are a few tips how to use hindsight to your advantage:

- Evaluate whether you can improve take profit or stop loss placement looking back at trades after you have closed them
- Analyze trades that you have missed and evaluate whether some of your entry criteria keep you out of profitable trades
- If you have followed your rules, but see that a trade would have moved further, or entering a trade early would have made you more money, do not punish yourself. Instead, pride yourself for following your trading plan – religiously following your trading plan is a key attribute of a professional trader
- Do not let the potential outcome of a single trade affect your trading decisions on your next trade

3. 18 proven biases that cause trading failure

"The eye sees only what the mind is prepared to comprehend."

- Davies

The human brain is a fascinating machine. It allows us to do many things simultaneously without having to think about doing them. You can drive a car, have a conversation about a complex topic on the phone, eating a sandwich, observing your daughter on the back seat, while all your inner organs and body mechanisms do their thing; this all happens effortlessly and humans wouldn't be able to consciously control what is going on anyways.

This is only possible because our brain uses shortcuts to process data and information automatically. Unfortunately, those shortcuts don't always work in our advantage and especially trading and investing require a different skill set and way of thinking.

The automation of thinking and making decisions is done through psychological biases or heuristics. We compiled a list of the 18 most common biases and heuristics and show how they influence trading decisions.

Heuristic	What it means…	How it influences traders
Availability	People estimate the likelihood of an event based on how easily it can be recalled.	Traders put too much emphasis on their **most recent trades** and let recent results interfere with their trading decisions.
Dilution effect	Irrelevant data weakens other more relevant data.	Using too many tools and trading concepts to analyze price could weaken the importance of the core decision drivers.
Gambler's fallacy	People believe that probabilities have to even each other out in the short term.	Traders misinterpret randomness and believe that after three losing trades, **a winning trade is more likely**. The probabilities don't change based on past results.
Anchoring	Overestimating the importance of the first available piece of information.	Upon entering a trade, people set their whole chart and analysis **in reference to their entry price** and don't see the whole picture objectively anymore.
Insensitivity to sample size	Underestimating the variance for large and small sample sizes.	Traders too often make assumptions about the accuracy of their system **based on just a few trades**, or even change parameters after only a few losers.
Contagion heuristic	Avoiding contact with objects people see as "contaminated" by previous contact.	**Traders avoid markets/instruments** after having a large loss in that instrument, even when the loss was the fault of the trader.

Hindsight	We see things that have already occurred as more probable than they were before they took place.	Looking back on your trades and **fishing for explanations** why the trade has failed, even though those signals weren't obvious at the time.
Hot-hand fallacy	After a success with a random event, another success is more likely.	Traders believe that once they are **in a winning streak**, things become easier and they can "feel" what the market is going to do next.
Peak–end rule	People judge an event based on how they felt at the peak of the event.	Traders look at a losing trade and only see how much they were **in profit at the maximum**, but don't look at what went wrong afterwards.
Simulation heuristic	People feel more regret if they miss an event only by a little.	Price that missed your target only by a little bit or a trade where you got stopped out just by a few points can be **more painful than other trades**.
Social proof	If unsure what to do, people look for what other people did.	Traders too often **ask for advice** from other traders when they are not sure what to do – even when other traders have a completely different trading strategy.
Framing	People make decisions based on how it is presented; a gain is more valuable than a loss	Traders **close profitable trades too early** because they value current profits more than a potentially larger profit in the future.

	and a sure gain is more valuable than a probabilistic greater gain.	
Sunk cost	We will invest in something just because we have already invested in it. before	**Adding to losing trades** because you are already invested, even though no objective reason to add exists.
Confirmation	Only looking for information that confirms your beliefs, ideas and actions.	**Blanking out** reasons and signals that don't support your trade and just looking for confirmation.
Overconfidence	People have a higher confidence than what their level of skill actually suggests.	Traders misjudge their **level of expertise** and skill. Consistently losing traders don't see that it's their fault.
Selective perception	Forgetting those things that caused discomfort.	**Traders forget easily** that their own mistakes and wrong trading decisions caused their major losses.
Beneffectance	Feeling responsible for positive outcomes but not for inferable outcomes.	Traders **blame the markets** or unfair circumstances for their losses and take full responsibility for their winners.

4. What does “Trade what you see” mean?

“Trade what you see” is a phrase traders love to throw around, but the true meaning behind it is mostly unknown. Trading what you see has become a hollow phrase and its true meaning has been forgotten. By the end of this article you will understand why you probably don’t trade what you see either.

> “Trade what you see is a deep-rooted psychological problem.”

Trade what you see vs. Trade what you think

Whereas “trading what you see” describes the optimal scenario in which traders make objective decisions based on sound price analysis, “trade what you think” is the exact opposite and it is how the majority of traders make their trading decisions – driven by emotions, impulses and wishful thinking.

7 tips to master the concept of “trade what you see”

Tip 1: The 5-seconds rule

Before you pull the trigger on your next trade, pause for a few seconds and ask yourself if this is really what you should be doing. Take the finger off your mouse, step back and objectively look at your chart. The concept of “what would the professional do” is not known to most traders.

Tip 2: Wait one more candle

This is something that has made a big difference in the lives of so many traders. Many trading mistakes can be attributed to early entries and entering positions that don’t meet all the criteria “yet”. Just waiting one more candle before making a decision can often turn the performance of a trader around.

Once you give this concept a try you will start noticing how difficult it is and how much your emotions drive your decisions.

Tip 3: Make candle by candle decisions

Mid-candle decisions are often, not always, the result of impulsive and emotional trading mistakes. Especially for new traders, not making mid-candle decisions can have a big impact on your performance. Not many people believe us but once they try it, they can see the difference. Just like the previous tip, once you start applying this concept you will notice how much you are really a victim of impulsive trading decisions – especially when you are glued to a screen all day long.

> “Mid-candle decisions should almost always be avoided.”

Tip 4: Use a physical checklist

We really want to drive this point home because it is so important. Write down all your entry criteria and place the list in front of you. You are less likely to break your rules if you can see them.

Tip 5: Separate trading from charting

We often encourage traders to use a neutral charting tool like tradingview.com for their charting and when watching the markets. Traders who only use one platform for charting and trade execution can see their orders at all times and are more likely to make emotional trading mistakes.

We explain how charting and execution should be separated in our latest article: The perfect trading routine

Tip 6: Have a trade plan for long and short scenarios

When writing your trade plan, always have a plan for long and short scenarios. Even if the market looks very bullish ask yourself "what has to happen so that I can go short? Where does price have to be." This will help you stay open minded and flexible.

If you are too focused on one side of the market, you always feel the urge to open a trade and act on your opinion.

Tip 7: Blank out other peoples' opinions

As a trader you have to take full responsibility for your actions. You need a consistent approach and trust in your method and your abilities. Be clear about your rules and your approach. Listening to other peoples' opinions has to be avoided. It leads to confirmation bias and trading without confidence and conviction.

Conclusion: What "trade what you see really means"

I hope that it became clear what the concept of trade what you see really means. Most traders re guilty of not knowing how to trade what they see and they are constantly acting on their emotional and impulsive reflexes rather than making objective and analysis-driven trading decisions.

5. The 5 stages traders go through

There are 5 stages every trader will go through over the years. You can't skip one and knowing which one you are in and being totally honest with yourself is essential.

Unconscious incompetence

This is the initial phase of a new trader when he is just getting his feet wet in the markets and looks at his trading platform for the first time. At that stage, a trader doesn't know how much he doesn't know, which can often be a liberating, but dangerous place to be in.

"You don't know how much you don't know."

His trading decisions are pretty much still a gamble and not backed by a sophisticated decision-making process; although the unconscious incompetent trader will never admit that – he doesn't know any better yet.

A few characteristics of the unconscious incompetent trader:

- He randomly opens and exits trades without a defined trading system
- He changes his "approach" on a trade to trade basis
- He does not apply risk management or position sizing principles
- He often changes his trade direction on the spot and chases price
- He gets motivated by winning trades and does not care much about losses
- Beginners luck is what keeps him going
- One loss often wipes out all previous wins

At this stage, the traders with beginner's luck are more likely to keep going and make it to the next stage. Often, however, traders lose money, get easily discouraged and acknowledge that trading isn't as easy as clicking a mouse.

Conscious incompetence

Now it dawns on the trader how little he knows and he starts to understand that he has to put in the work and study more. Motivated by a few lucky winners, he studies everything he can get his hands on.

A trader who still loses money consistently, even after spending a lot of time learning about trading, will often start blaming his tools, the wrong indicators, missing information or unfair markets; he is looking for external excuses.

This stage of conscious incompetence is the one that lasts the longest. Some traders will never leave this stage, even after years of being involved in the markets. A few principles and questions can make you aware of potential problems in your trading mindset and general approach:

- Have I changed my trading system more than once in the last 6 months without really putting in the work?
- Am I actively reviewing my trades to find out what is going wrong?
- Am I still making impulsive trading mistakes that cost a lot of money?
- Do I repeat the same trading mistakes over and over again?

Sit down and try to answer these questions. Be honest with yourself even if the truth hurts. Lying to yourself will keep you trapped in your current state and you won't be able to improve and evolve as a trader.

The Aha moment

It sounds cliché but this is the time when the trader accepts responsibility for his actions. He understands that all his past mistakes and false behavior will not get him anywhere. If a trader is really serious about making this work, there is typically only one way and the following principles describe the "new" mindset:

You can finally look beyond entry methods and finding better signals.

- He stops changing systems and focuses on making the one he has work
- He starts monitoring his behavior to find negative behavioral patterns
- He follows a daily trading routine, starts keeping a trading plan and a trading journal
- He understands that entries are just one part of his system and that, in order to become profitable, he has to work on all components of his system

Conscious competence

The trader now starts to realize what trading is all about. Although trading is still not easy and his results are far from being perfect, he understands the importance of process-oriented thinking. He stops focusing on only the outcome of his trades.

Traders at this stage are typically break-even traders and slowly start to turn their equity graph up. Discipline, emotions and adequate risk management are of utmost importance at this stage and a long-term approach will keep the trader from falling back into old habits.

The trading journal becomes his most important companion at this stage because it provides an objective look at his performance and behavior. Traders at this stage are very likely to make it to the next and final stage. They can see that their work is starting to pay off, they stop system hopping and focus on their process-oriented approach.

Unconscious competence

This is when trading becomes boring – and trading should be boring! At this stage, the trader has spent years of looking at screens and taking the same setups hundreds or even thousands of times. He knows exactly how his preferred setup looks like and trading becomes a waiting game.

At this stage, the trader has fully internalized that he can't win every trade and, more importantly, he does not really care about losses as long as he has followed his rules. Trading is now an activity of pattern recognition, risk management and constant self-improvement.

The unconscious competent trader has a thirst for self-improvement and constantly studies the markets. He evaluates the effectiveness of his method and he is driven by the success and his improvements so far.

Which stage are you at right now?

Being a trader is a life-long journey of self-improvement and self-discovery. The markets teach you something about yourself every day. In fact, a trading plan that makes money for a trader is simply the extension of his own personality with all its qualities and imperfections.

Your task right now - if you are not a consistently profitable trader yet - is to sit down and take a deep look at yourself. Then try to answer the following question: which stage are you at right now?

Try to answer this question as best and honest as you can. The moment you answer this question, and draw the consequences from it, you will be on your path to improving your trading bit by bit until one day you will finally reach controlled profitability.

6. Fear of missing out - FOMO

At any given moment of the day, there are thousands of markets waiting for you; hundreds of thousands of charts are moving 24 hours a day, 5 days a week and every tick means that you could make money.

Dealing with missed trades can be a real challenge for traders and every day you have to deal with all the money that did not end up in your trading account. Seeing how much you could have made can often pose great challenges on a trader's mindset and then lead to great mistakes.

8 things a FOMO trader says

If you find yourself among the following points, FOMO trading plays a role in your daily routine:

- "I knew it!" – the trader who followed a setup but didn't take it
- "Not this time." – the trader who enters too early after a missed trade

- "I could have made so much money today." – trader beating himself up with the benefit of hindsight
- "I waited so long for this trade." – the overly anxious trader stalking a setup with a trigger-finger
- "It still has room to go." – the trader who jumps in late after being too scared to enter first
- "I have a feeling…" – the trader reasoning himself into a trade without all entry criteria
- "One time." – the trader in a speculative trade, hoping to get lucky
- "I just enter with a small position." – the trader justifying breaking his rules

What drives FOMO trading (Fear of missing out)?

Trading is an activity without a clear beginning or ending and as soon as you start your trading computer, you are in the middle of the game and it does not stop – ever. In an activity without a beginning or ending, you can always make decisions and at any point in time, you could enter a – potentially – profitable bet that could make you money.

A football game, a roulette spin or blackjack have defined beginnings and endings; you know when to start and after the game is over, you can't change anything. You have to accept the outcome. It's not open for interpretation; you (your team) have lost or won.

In trading, the "game" never really starts and it doesn't end either. And the outcome is never really finalized until you close the trade; and even then you can just get back right in. With every tick you see in the market there are profit potentials and you are just one mouse-click away from – potentially – entering a trade that could bring you a lot of money. Missing a trade seems like leaving money on the table.

Now, let's take a look at the three scenarios around FOMO trading.

1 - You enter early because you don't want to miss out

How often did this happen to you? You created a trading plan, waited for all things to fall into place and then, just before your setup is completed and price reached your entry level, price is starting to take off and it looks like it's going to leave without you?

You can't let this trade leave without you, right!? So you enter early, violate your trading rules. Entering a trade too early means that your risk is completely off because your stop loss is going to be much further away because of your early entry. Furthermore, do you add to your (losing) trade once it reaches your original entry level and increase the risk even further? Those 2 points show why an early entry completely throws off your position sizing and risk management.

And what happens afterwards? You end up with a losing trade because, after all, you never saw all your entry criteria confirmed and you had entered a trade you shouldn't be in in the first place.

2 – You wait for price to show the perfect setup and then miss the trade

Missing a trade that leaves without you because the entry signal happened too early and without really showing you all the criteria is painful. Traders who are in a “missed a trade” mindset tend to chase price or enter the next trade earlier – we just saw why this is a bad idea.

Traders who miss trades interpret the event completely wrong. In the end, it wasn’t a setup based on YOUR rules after all and you have your rules for a reason. Sure, sometimes you could end up with a winner violating your rules, but over the long-term, your rules protect you and your capital.

“Missed trades cost nothing.”

Always remind yourself: a scenario might have been an acceptable trade based on someone else’s rules but it’s not for you! Profit-opportunities will occur ALL THE TIME and you won’t participate in all of them. Your rules will only enable you to engage in some of the millions of opportunities that exist every day.

3- You wait until you get the perfect setup

Of course, this is the ideal scenario and the way it should be. There are ways to get into the right mindset so that finding good trades doesn’t have to be a seemingly impossible task, but becomes the norm.

A trading plan and a trading checklist are two must-have tools for traders and we have talked about both before. In you trading plan you map out potential trade scenarios so that, once your trading sessions start, you only have to wait until your entry criteria are met. The checklist holds you accountable and visualizes the trade progress. Violating your trading rules becomes much harder if your plan and checklist tell you to stay out and you have to convince yourself why violating your trading rules is the right thing to do.

“I review my checklist. It’s a handwritten sheet laminated in plastic and taped to the right-hand corner of my desk where I can’t overlook it.” – Marty Schwartz

7. What happens when you marry a trade?

If you are a trader, you are in the business of decision making; every day you have to make decisions about what to trade, when to buy, how to maneuver your orders, when to exit and how to react to changing conditions.

If you want to be a successful trader, you have to make the right decisions. Of course, this is easier said than done and there is a lot to it; but there is one component of the decision making process which stands out and it influences your actions on a daily basis and usually you don't even know it.

Do you enter only good trades? The truth about marrying a trade

am sure that you only want to enter 'good' trades and avoid making bad decisions. There is one psychological bias which messes with our minds and it creates the effect which traders refer to as "being married to a trade".

"Never marry a trade. The divorce is usually very expensive."

There was an experiment where professional horserace handicappers (people who bet on horseracing) were asked to estimate the likelihood of certain outcomes of horseraces before they had placed any bet.[1] Then, they had to actually make a bet on some races. After they had placed their bets, they were asked again how certain they were about the outcome of the race.

The findings were very obvious; after they had placed their bet, the professionals were much more certain and convinced that their decision was the right one, even though nothing had changed.

What happened that made the professionals take a much stronger opinion after putting down the money?

Gaining certainty - how we fool ourselves every day

The psychological phenomenon at work is called “cognitive dissonance”. As humans, we like harmony and order in our lives; if something is not going according to plan, we fix it and find solutions to bring everything back into a state of order. Investopedia defines cognitive dissonance as “the unpleasant emotion that results from believing two contradictory things at the same time.”[2]

The horse bettors bet their money on a certain outcome and in order for them to achieve a state of harmony, their minds made them believe that their decision was the right one. It creates a lot of stress if they would have started doubting their decisions and we usually do everything to avoid doubts and stress.

In trading, it works exactly the same. We buy a certain instrument because we believe that its price will go up. But, if prices start falling and our position moves against us, we look for information that confirm our initial idea. We try to create a state of harmony and congruency by creating a strong sense of certainty. The more price goes against us, the more certainty we need to avoid cognitive dissonance, which then creates the effect of “being married to a trade”; we can’t cut our loss because it would confirm that we were wrong.

An example of cognitive dissonance in trading

The screenshot below marks a hypothetical long trade just before price started plunging. To stay in the trade and to justify his position, the trader looks for all the confirmation he can get his hands on. Usually, traders start looking for outside confirmation, apart from their actual trading system or style; a technical trader looks for fundamentals and news that confirm his idea and the macro trader suddenly starts consulting indicators.

> "It's easier to resist at the beginning than at the end." - Da Vinci

The more the trade goes against you, the more you have to lose by closing out the position and realizing the loss. Traders misunderstand unrealized losses and they often treat them as not real. Thus, cutting your loss as soon as possible is a must. In trading, being wrong is no big deal and it happens all the time, but staying wrong is a cardinal sin in trading.

References:

[1] Paul Slovic, "Behavioral Problems of Adhering to a Decision Policy," unpublished manuscript, 1973.

[2] http://www.investopedia.com/terms/c/cognitive-dissonance.asp

8. What traders can learn from a professional gambler

Cathy Hulbert is a professional ‘gambler’ who made a lot of money playing blackjack, slots and poker professionally over decades. I recently read the book ‘Gambling Wizards’ where she was featured, among other professional gambling legends. One passage struck me immediately because adopting a similar attitude could help traders perform much better and avoid unnecessary mistakes. Let me quote the passage from the book:

How the professional prepares for a session:

“Cathy: Before I go to play, I don’t engage in any other activity […] I don’t take phone calls. I don’t socialize. I don’t plan any social event afterward. I don’t want any time restrictions. I want my mind to stay as peaceful and restful as possible. I go to bed at exactly the same time every night and get up at exactly the same time every morning […] I don’t drink any alcohol the night before I’m going to play [...] When I’m driving to the casino, I’m very aware of how irritated I am at other drivers […] The calmer I am, the better I know I’ll do […] If I’m driving like a maniac, if the light turns yellow and I’m rushing through, I’ll think, OK, you’re in a bad state today […]

Interviewer: Do you still play?

Cathy: I play lower. I make a mental note to watch what’s going on with myself […] I don’t want to tak a $5,000 loss because I’m in a terrible frame of mind.”

Trading is a mental game

Become a Profitable trader

As a trader, you don't have to be super smart, although you need to be educated to some degree, you don't have to necessarily understand all macroeconomic factors, although it helps to form an opinion, and it's not compulsory to be an avid accountant and being able to read through company balance sheets.

A professional does not have a better system. He can manage himself better.

Although having a tested and sophisticated approach is very important, the difference between an amateur and a professional trader lies somewhere differently. The reasons for unnecessary and avoidable losses of amateur traders can often be attributed to the following 5 points:

- **Revenge trading:** you open a new position just after your stop is triggered, without seeing valid re-entry signals.
- **Playing catch up:** you want to make up for past losses, force trades and violate your rules.
- You flip through your charts without really knowing what you're looking for and then take trades that don't meet your criteria.
- You want to avoid losses and, therefore, widen your stop loss order or take it off completely.
- You miss a trading setup and then jump in too late, although you should have stayed out by then.

If you are honest to yourself, you will know that you have probably engaged in at least a few of these 5 negative trading patterns. There is nothing to be ashamed of because most traders commit to the same actions and repeat their mistakes over and over again. If you objectively look back on your trading performance, most traders will see that the reason why they are not making the money they could be making is not because of the absence of a good trading strategy, but their repeated engagement in impulsive, emotionally caused trading decisions. It is safe to assume that most traders had a much better performance - some losing traders might even be break-even or winning traders - if they just had avoided the 5 previously mentioned mistakes.

Trading is a performance game and it's not the trader with the most sophisticated trading strategy that will come out ahead, but the one who can control his emotions and attitude most effectively.

Self-awareness

Self-awareness is a character trait that is important for being successful, not only as a trader, but in life in general. Self-awareness means that you are aware of yourself. This can include your strengths and weaknesses or your current state of mind and your emotional status.

Daily self-awareness and the ability to assess your current state of mind is important as a trader. Since being a trader means that you have to continually make decisions that can cost or make you money, and even result in major losses, making sure that you perform at your best level is important. However, most traders just see trading as a job where they HAVE TO sit in front of their desk from 9 to 5, regardless of how they feel.

Check your state of mind

The power of money

Every morning, before you start up your trading platform, take some time to assess your current state of mind. The following points can serve as a guideline to evaluate yourself:

- Do you feel sick? Although it is obvious that you shouldn't trade if you are sick, most traders don't think that way and still trade as normal.
- Have you had enough sleep? A sleep deficit has severe impacts on performance and how we react and interact with the markets. As a side note, this also holds true if you had too many drinks the night before.
- Are you angry or aroused? An argument with your spouse or a serious conversation at work can, and will, carry over into your trading routine and will create a lack of focus.
- Over-excitement, on the other hand, can also significantly influence your decision-making process. Being too euphoric can be dangerous because you might analyze risk wrong or are too casual about potential losses.
- If you are coming from a winning streak, traders also tend to feel too confident and, therefore, be less risk averse. This usually leads to excessive risk taking.

  On the flip side, coming from a losing streak can make you be too cautious and, therefore, make you miss potentially profitable trade.

"Not the trader with the best trading strategy will come out ahead, but the one who can control his emotions and attitude most effectively."

To assess your current situation, observe how you react and interact with people and situations around you. The quoted passage from the beginning gives a few helpful tips how your actual behavior and perception of the world around you signal your current state of mind.

If you feel not too well and you answer most of the questions above in a way that signals that you are not in the optimal state of mind, don't trade! Take the time before lunch off, or even take the whole day off. You will always get another trade, but you can't get back the money that you lost by making an unnecessary mistake. Another way of avoiding unnecessary mistakes when you don't feel well is that you trade smaller positions. If you normally risk 2% per trade, go down to 1% or 0.5% until you are sure that you feel better. Trading is not a business where you get paid by the hour, but by your performance.

9. 4 tips to become an elite performer

I recently came across Josh Waitzkin after listening to his interview with Tim Ferriss. Josh Waiztkin became a chess ‘superstar’ as a child and a grandmaster later on, before making a radical change and pursuing a career as a martial artist. In both fields he made it to the top of the world. Josh Waitzkin now also does consulting for high achievers and also coaches top traders and people in the finance industry.

In his book “**The art of learning**” he shares many different tips, techniques and concepts on how to develop superior skills and become better in virtually any field. I condensed 4 of the most important lessons from his book and put them into the context of trading. But I still encourage you to get the book for yourself to learn about all the other lessons and tips he shares – it will definitely be worth your while.

Regaining focus in times of adversity

Waitzkin often had to make tough decisions under very challenging conditions – in the heat of a chess battle or during a martial arts fight. Keeping in control of your emotions is the most important factor and what separates the winner from the loser.

In sports, did you notice how some players put a towel over their head when they sit on the bench, tennis players pick their rackets and other athletes don't even look at the field during a time-out?!

Waitzkin emphasizes the importance of regaining focus, separating yourself from the scene to get a new perspective and a clearer view. He did that by splashing water into his face, getting up and getting a drink of water, deep breathing, and even doing some physical exercise. He calls is "psychological flushing" because it takes your brain off the subject completely for a minute or two. Afterwards you come back refreshed and with a brand new perspective.

Mental flushing is a powerful technique to reset your state.

As traders, we almost daily deal with challenging decisions and how we deal with the psychological aspect of trading makes the difference between win or loss. Making a bad call right after a loss or an impulsive move after missing a trade are just two examples. If you find it hard to deal with emotions, separate yourself from your trading platform after a trade. Just walk away for 5 – 10 minutes, do something completely else and when you come back you can look at things in a different way.

Attention deficit and being present

Every day we are bombarded with exciting news, flashy advertisements, attention-grabbing headlines and highly inspiring stories. What this does to our minds can be deadly for high performers. We are so used to seeing new and exciting things all the times that we get bored easily. When nothing happens, we are looking for distractions which then often lead to making mistakes.

Trading isn't always exciting and sometimes the markets just don't do anything for hours or even days. How you deal with these situations decided over your fate as a trader. The professional traders stay focused, they analyze their past trades, they revisit their trading plan or journal their trades. Or, they just walk away and use their 'free time' in a more creative way. On the other hand, the amateur trader tries to create excitement. He randomly flips through time-frames, charts and markets and tries to make up excuses why taking a trade would be the right thing to do.

Know your strengths

"…almost without exception, champions are specialists whose styles emerge from profound awareness of their unique strengths, and who are exceedingly skilled at guiding the battle in that direction." – Josh Waitzkin

How did you 'find' your current trading system? Did you buy it from a landing page? Is it an indicator package you downloaded in a forum or something you picked up in a chatroom? A trading system is a very personal thing and it has to be modeled around your personal strengths and weaknesses. Audit yourself: Are you patient? Risk seeking? Can you deal well with losses? Can you focus for a long time without needing a break? Do you easily screw up once you are in a trade or can you handle retracements?

It becomes obvious very quickly that traders should adjust their trading parameters according to their own profile. One size fits all does not work.

Making smaller circles

5stepsThe professionals don't get wind up in fancy techniques. In competition, those who win are usually the ones who have better honed skills and it is not the one with the most creative or extravagant technique.

Making smaller circles describes the concept of picking one thing and learning everything there is to know about it – starting with the most important concepts and working your way up to the nitty-gritty slowly. Traders often jump around systems, look for fancy and new indicators and try to come up with trade entry signals to outsmart the market.

Instead, you should focus on one thing at a time. Identify your greatest problem and work on it. Is it really an 'inaccurate' indicator setting that keeps you from winning or is it more likely that your mindset and general approach is not where it should be? Try to understand and overcome one obstacle at a time and always focus on your greatest challenges first.

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