Overcoming the Psychological Barriers To Trading Success

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Chapters:

1. Problem Behaviours that Prevent Trading Success

The list of problem behaviours listed below came from a survey of active traders.

- Exiting profitable trades too early
- Staying in profitable trades too long
- Setting too tight stops
- Moving stops further away and running losses
- Over trading
- Under trading
- Perfectionism – the need to be right
- Can't read the market

Exiting profitable trades too early

Exiting profitable trades too early was the most cited trading problem; we all suffer from this to some degree. Exiting a profitable trade because the market is telling you to exit is not the problem here; the problem is when you exit for no good reason except that you fear the market will turn against your position. So this behaviour stems from fear of loss.

Underlying Problem: Fear of Loss

Staying in profitable trades too long

Have you ever held onto a profitable trade too long, until the profit has all but disappeared or turned into a loss? Letting it run too long to me is similar to running a loss because the problem stems from not accepting the perceived loss. So if a position is up $500 and then slips and is now up $400, some traders will find the $100 loss difficult to accept and will now wait for the position to get back to $500 profit. Of course the market will either go further against the position (resulting in greater resistance to the loss) or it will go back to where there is a $500 profit. The problem is that when the position does get back to a $500 profit, it looks good and the trader will probably now wait to see if it will go further. Either way they find it difficult to get out of the position!

Underlying Problem: Unwilling to Accept Loss

Too tight stops

Placing tight stops gives you the feeling of control, but will most likely result in getting stopped out of a position even when you are right. There are times when a tight stop is fine (see Reading The Market below), but if you regularly use tight stops which get you stopped out of a potentially profitable position then this one applies to you. Why would you place too tight stops? Presumably because you fear that this trade will be a loser and the tighter the stop the less the loss. (If you ***knew*** the trade was going to be a winner you wouldn't want to place a stop at all!)

Underlying Problem: Fear of Loss

Repeatedly moving stops further away and running losses

Running a losing position in the hope that it will come back is a very common trading ailment. I am very familiar with it and you might want to read my article "What I learnt Losing £60,000 ($120,000) my first year as a Professional Trader" to see how I overcame this problem. The article is in the Appendix of this document.

Not sticking to an original stop loss on a position is due to your inability to accept the loss. By holding the losing position you are hoping that the market will come back to breakeven or better. When the market goes further against you, you start to hope it will come back to your original stop position. The further the market goes against you and the bigger the loss the harder it is to accept the loss, until it is so big that you have to exit.

Underlying Problem: Unwilling to Accept Loss

Over Trading

The problem traders have mentioned that come under this category include: not sticking to plan/system, taking trades for no clear reason, taking too big positions, second guessing/outsmarting/pre-empting system or strategy. As one respondent pointed out, when you indulge in over trading you waste your energy and may be too exhausted to take the next decent trade.

For me overtrading is about trading when I don't really want to, if I listen to myself I can avoid this, but it is difficult because we have been bought up to believe that hard work equals long hours and overriding our desires with will power.

Perhaps though a more insidious cause of over trading is lack of confidence; either in yourself as a trader, or in your strategy or approach to trading. If you believed that your strategy and your trading skill was going to present endless low risk, high profit opportunities, why would you waste your time, energy and capital taking high risk, low profit trades?

Underlying Problem: Lack of confidence

Under Trading

This seems fairly straight forward to me, under trading stems for a fear of loss and a fear of being wrong.

Underlying Problem: Fear of Loss / Fear of being wrong

Perfectionism – the need to be right

I think this is a natural tendency, we all want to right all the time. This has been reinforced by our upbringing as well, when was it advocated that being right 60% of the time was the ultimate achievement? But in trading the only way to be right 100% of the time is to never trade! So to be a successful trader we have to accept losses, there is no other way.

Trading is much more akin to sport in this regard; there is no sport that you can excel in if you can not accept loss. In fact I would say that great champions are great because they can accept defeat; as it is only by accepting the possibility of defeat that they are truly free to play. That does not mean that they want defeat, but they know that putting themselves in a position to win also exposes them to loss.

The problem that a gambler has is that he has not accepted the possibility of loss and when it comes he fights it instead of accepting it. It may be as a trader that you have developed a strategy that appears to be 100% profitable. For example options traders who sell options have a very high probability of profit, but the downside (when it comes) can wipe them out. So a high probability system gives the impression of a perfect system, but invariable it comes with occasional, but huge, drawdowns.

Underlying Problem: Fear of Loss / Fear of being wrong

2. How to Overcome the Psychological Blocks to Trading Success

Before I move onto the problem of not being able to read the market I want to consider the underlying issues that lead to the problem behaviours listed above. They are:

Fear of Loss
Unwillingness to Accept Loss
Lack of confidence
Fear of being wrong

Fear of loss and the unwillingness to accept loss can be the legitimate fears of someone who is undercapitalised. In that case it is best not to trade until you have sufficient funds both for trading and living expenses. But what we are interested in is when these fears ***are present***, but are ***not*** due to insufficient capital. When money is not the root of the problem, the root cause has to be the fear of being wrong. Losses are the trading equivalent of being wrong, and being wrong is something we have been brought up to avoid at all costs.

So we are left with two underlying issues, the fear of being wrong and lack of confidence. Let me ask you these four questions:

1. Does Roger Federer (possibly the greatest tennis player ever), who is extremely confident in his tennis ability, fear making a mistake?
2. If you were playing Roger Federer in a tennis match, would you be anxious?
3. If you feel very confident do you fear being wrong?
4. If you feel very unconfident do you fear being wrong?

Hopefully you will have answered no, yes, no, yes to the above questions and it will be apparent to you that the fear of being wrong stems from lack of confidence. So my conclusion is that all the problems that have been identified in this survey stem from one key factor: **lack of confidence or self belief**.

How do we build confidence?
Confidence (self belief) is a product of sustained success and consistent behaviour. When I was learning to stick to my daily loss limit of £500 ($1000), I was losing every day, but my confidence was growing. It was growing because I was discovering that I could stick to a loss limit, it was hard at first, but I could do it. Before I had this limit I didn't know whether I was going to have a good day or a really bad day, so I was (without realising it) scared. Once I had demonstrated to myself that I could control my losses by sticking to a daily loss limit, I started to relax and enjoy trading. As I started to relax I became more aware of what was happening in the market and I started to make observations that led to profitable trades, which in turn grew my self confidence as a trader.

So to build confidence I believe you have to start by proving to yourself that you are trustworthy, that you aren't going to lose your shirt. I have come across a few traders who think that they are disciplined, but in truth it transpires that they don't really take any risks. No one knows how they will respond under pressure until they are actually under pressure… so you have to trade!

I am a day trader, so I will just talk about day trading, but you can create similar rules for yourself if you are a position trader. As a day trader you have to have a daily loss limit, which will be a % of your trading capital, in the region of 2-5%. Starting with a small account you will need to risk more, so for a $10K account a daily loss limit of $500 is about right; but as your account grows you will probably want to risk a smaller %.

You also need a daily target, which will be a multiple of your loss limit, say 2 X. So in the example above your target would be $1000. You can add a rule that once you reach the target you can continue to trade, but you must stop if you give up 20% of your maximum gain. So if you are up $1500 and it slips back to $1200 you must stop.

If you are a trader who finds it hard to pull the trigger then you need to make a commitment to yourself that when you trade you will trade until you hit your daily loss limit or your daily target. You have to be in the market trading to develop your awareness and feel for the market. It is no good relying on indicators and systems without developing your market nous (trading smarts).

3. How To Read The Market

Some of you feel that your difficulties in trading come from not being able to read the market. There is no underlying psychological issue here! Reading the market comes primarily from experience. It is also helpful to have a few key concepts and perceptions pointed out to you, which is what my **Day Trading Mastery** course is all about.

In the course I will teach you exactly how I read the market. My techniques are not very technical as I evolved my trading style as a floor trader and I believe anyone can learn to trade in this style. My approached is based on reading the order flow; I observe the impact of new orders on the market. I focus on the depth of market, the time & sales and 5 & 1 minute candlestick charts.

Although I focus on trading Financial Futures, mainly the E-Mini S&P, my approach is applicable to any market. All markets are driven by order flow. When there are more buy orders entering the market that sell orders, the market will rise and vice versa. Below are extracts from 2 emails I have recently received from clients (sent to me without request). One is from an E-Mini trader and one from a Forex trader.

Email 1:

Hi Malcolm,

Want to mention that the materials I received from you (your FTSE and eMini trading strategies) are the best techniques that I have ever seen and used in the markets. I have adapted the eMini method slightly (multiple lots, liquidated in stages at different profit objectives) for use in the Forex market, trading around US Report times, using primarily the 5 minute chart but also the15 minute chart from time to time, depending on the “set-ups” that are occurring. The results to date are not just good, they have exceeded my expectations for a practical day to day, “bread and butter” type trading methodology. I’m not talking about short term results but results over a reasonably significant period of time. (I use tick type volume as opposed to “real” volume and it works just great for me.)

Your FTSE and more importantly your eMini strategy is the best investment I have ever made in market materials.

Best,
K (name withheld for privacy)

Email 2:

Hello Malcom,
Thank you for the excellent training DVD "Day Trading the E-mini SP." I have found it to be extremely useful in many areas. I have been trading for over 30 years, primarily in stocks and options. I also worked on the trading floors for over 18 years. The last few years I have been working on mastering trading the SPs and the Russell with mixed

success. However, since receiving your video, I have gotton a new perspective and am seeing dramatic improvement in my profitability. I have just completed 10 days of consistant profits and that is absolutely a first for me. Of course, there will be negative days, but with the methodology you have demonstrated, I feel losses will be manageable. Have had many losers over the past 10 days, but the % is strongly with the winners.

I have a some questions however. I will try to be as direct as possible:

1 If taking a trade off of a 5 min bar, how long do you maintain the original stop? Do you recomend moving it up after a reasonable period, such as 4 bars or do you just leave it place no matter what? I have experienced potential reversals signaled in both candle formations and with volume confirmations and have found it fruitful to honor them even though the original goal has not been reached.

2 Also, I like to put on a 2 lot and take one off relatively quickly, idealy equal to the stop, to place the trade in a no-lose position. I then leave the 2nd lot on till goal achieved unless a very strong trend develops in which case I will utilize a one-bar trailing stop of a one tick reversal. This sometimes lets me stay in a winner much longer.

As an example, I had trades this AM in both the Russ and SP in which I was able to take off half for $50 and move stop to one tick below entry bar. I then exited both 2nd lots on a reversal bar several bars later with out achieving goal of original entry, however profit was fully banked. The entry signals have such a high % of winning at least a point or two which ensures profitabilty and avoids stop outs.

Again thanks for the DVD course. I can absolutely say it is worth 10 times the price to me. I appreciate your help.

Yours truly, P.L. (name withheld for privacy)

Semi-Live Event

The course is run on the internet as a semi-live event. It is live in the sense that it is run over the course of a week and the trade examples are current. There is the opportunity to ask questions and have those questions answered during the course. It is semi-live because the course is a series of video presentations that include live trade examples. There is no requirement for you to be in a certain place at a certain time as the videos can be watched in your own time when it is convenient to you. The course is spread over 5 days to make it easier to take in the information and give you time to ask questions. You will continue to have access to the films after the course if you wish to review them at a later date.

So if you want to find out more and register your interest in the next course (they are conducted online) visit **www.TheMasteryOfTrading.com**.

4. Summary

Until you are a consistently profitable trader you aim is not so much to build your account, but to build your confidence and self belief. Sticking to your daily loss limit consistently will build self trust which, in turn, will relieve anxiety and allow you to observe the market. Observing the market from a relaxed and open position will allow you to discern trading opportunities (this skill will evolve over time), which will lead to profitable trades. Small regular gains build confidence.

One note about my own experience; before I started to trade with a daily loss limit my trading was wild, I had some big losing days. My biggest one day loss was £15K ($30K) which at the time was huge as it was all the money in my account. So when I started to trade with the limit at first I kept losing it in the first few minutes of trading, which was very frustrating, but I knew I had to stick to my limit or my trading days were over. I really wanted to be able to trade all day, so I was forced to start being more risk averse. Before I had been far too gung ho, but restricted by the loss limit I had to become more discerning and pick my spots carefully. So don't be discouraged if you find this very hard at first, you will adapt and you will become a better trader.

I wish you success,
Malcolm Robinson.