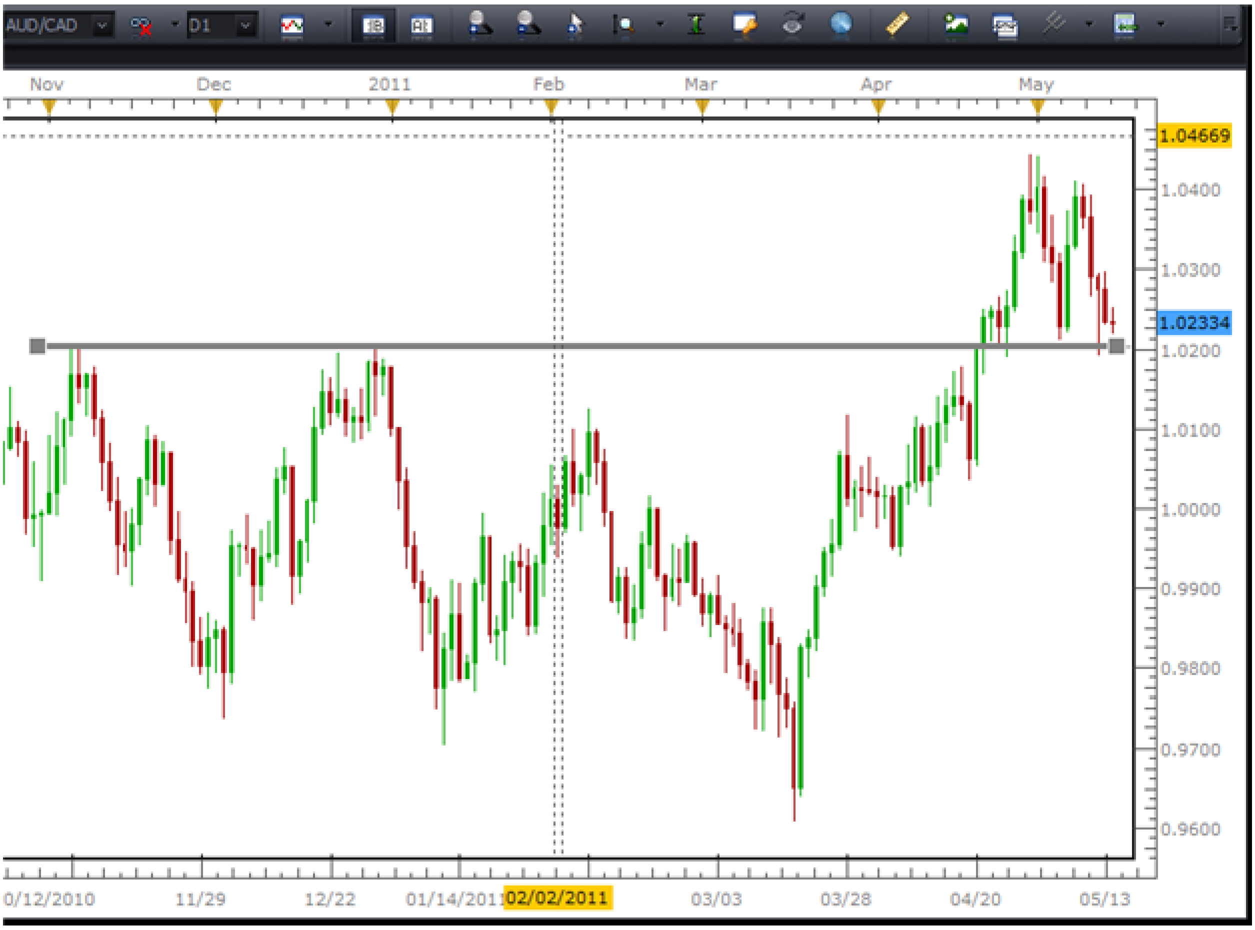
Trader Psychology: Trade to Trade Tomorrow

There has been much said about the psychology of trading and the necessity that we manage our emotions with every gain and loss. Emotions tend to rise to the surface during times of uncertainty as we are faced with an unexpected situation or crisis. How would we feel to win the state lottery worth over $100 million? It is easy to say, we would feel very surprised and in fact ecstatic. On the other hand, how would the average person feel to lose their life savings in an investment of some type? Most would assume he/she would feel pretty horrible. These emotions should not come into play as we trade our accounts. Speculating in the financial markets should be approached with the same planning, research, and discipline in its execution, as a small business owner spends each day making decisions in order to improve revenues, and reduce risk. It would be absurd for a business owner to fall into panic during the first or second slow day of sales. We would logically expect that entrepreneur to simply review the mission statement and ensure each one of his/her actions has this mission statement and long term business plan in mind.

Let's take a look at a current trade set up on the AUD/CAD daily chart below:



The AUD/CAD is in a clear uptrend and we can see the clear break above the 1.0200 area which is represented by the horizontal line. Prices are now testing the previous resistance zone from the opposite side. We might look for the 1.0200 area to act as support as past resistance usually acts as future support. This has been confirmed with price action finding support near the 1.0200 area during the past few sessions. With prices currently at 1.0233 we might place an entry order at 1.0225 with a stop at 1.0175, risking 50 pips in the trade. We might place a limit at 1.0375, so we are risking 50 pips to make 150 pips for a 1:3 risk to reward ratio.

This is a trade set up. That is all. This is one of several thousand trades that I am going to make during my trading career. The results of this one single trade do not matter at all. The trade may or may not work out, but that has absolutely nothing to do with my analysis. One of the most common mistakes I see in newer traders is that they put too much emphasis on the current trade. They live and breathe for that trade. Again, we have to treat trading like running a business. It is a numbers game. With a consistent approach and a respect for risk we should decrease the importance of the current trade and think of it in terms of the long haul. In other words, we should trade to trade tomorrow.

Trader Psychology: The Fear of Missing Something

In my opinion, the fear of missing out on something is the most common emotion that causes traders to push the buy or sell button when they should not. When a trader makes a profitable trade, chemicals are released in the brain allowing the trader to feel pleasure. It is the desire to re-create that pleasurable feeling which clouds objective thought and leads to poor trading decisions. When looking at potential trades, there are always many variables to consider which would depend on that trader's trading plan. A set up might present itself and the trader will then weigh all of those variables. When considering an entry a trader will think about the possibility of a loss and also envision potential profits. It is when thinking about the potential profit that traces of the chemical that cause the feeling of pleasure will be released. The brain wants the real thing, not just a trace, and that is where the subtle, almost unconscious shift in reasoning occurs. The trader then pushes the sell or buy button with a less than ideal trade set up.

Action Points
This is the normal reaction to price action, we are only human. Awareness of any problem is the first step to recovery. There are things a trader can do to mitigate this potential psychological pitfall.

Be Honest with Yourself – Before you enter a trade, ask yourself if you are entering because you see a clear trading opportunity or if you are entering because you are scared of missing out on potential profits.

Use Entry Orders – Entry orders are a great way to make sure that you are entering the market on your own terms and not because you are scared of missing out on something. To place an entry order, click on the entry order tab. The Entry Order box will appear. Select the pair, whether you want to sell or buy and that rate at which you want to do so. You can click the advanced tab to input stops and limits. These orders will remain active even if you log off.

Use Price Alerts – Another way to help overcome the fear of missing out on something is to use price alerts. We can be notified when prices reach a certain level. This is a great tool when you want to see how prices react when they reach an important technical level, such as a support/resistance line or major Fibonacci Level.

The fear of missing something is one of the key roadblocks to trading success. The three methods described above can help a trader overcome this potential problem.

Top Ten Trading Psychology Myths

Top Ten Trading Psychology Myths

1. People are born traders. While it is true that certain personal characteristics make it easier to trade, no one is born a trader. One of the main themes of the Market Wizards books written by Jack Schwager is that almost none of the market wizards was successful from the start. They all worked hard at it.

2. You have to have a high IQ to trade. Just not true. In some ways, an above average IQ may be a hindrance. Trading is a human performance activity where strong intellectual abilities are unnecessary.
3. Top traders are successful because they have the “right trading personality.” There is no such thing as the “right trading personality.” Researches have been unable to find a strong correlation between personality type and trading success. It is important, however, to understand your personal characteristics and how they may help and hinder your trading.

4. Trading is easy. It sure looks that way, doesn’t it? Just draw a few lines on the chart, watch your indicators, and follow the price bars. The truth is that trading is a difficult business to master. It involves different skill sets and abilities from what are needed in most other professions and careers. The trader must understand his or her personal strengths and limitations and develop specific skills to deal with the mental and emotional demands of trading. The later skills are the most difficult to develop and the most overlooked.

5. You must be tough, hard charging, and fearless to be successful. That’s more media hype than anything else. It glorifies a strong ego, which is a detriment in trading. The most successful traders I know quietly do their research, study the charts, and patiently wait for the right moment. They strive to keep their ego out of their trading.

6. You must trade without emotions. If you are human, that’s impossible. More importantly, when you understand your emotions you will realize they are assets, not liabilities. The real keys are: 1) to be aware of how your emotions interact with and influence your trading, and 2) to develop the skills needed to trade with them.

7. Top traders are usually right about the market. Top traders have many, many scratch and losing trades. Top traders are at the top because they exercise good risk control, limit the amount of loss from any given trade, and have developed a psychological edge that allows them to be unfazed by small loosing trades. Most of their trading consists of modest profits and very small losses. When conditions are right, they step up size and let the profitable trades run.

8. Paper trading is useless-it’s not a real trade without money behind it. If you aren’t paper trading, you are doing yourself a disservice. You should always be paper trading your trading ideas. Why limit your education and experience by the amount of capital you have? Paper trading keeps you sharp; you learn the conditions under which your trading ideas work best. Where else can you get such vital education at so little cost?

9. Master the technical skills and you will be successful. This is where most traders spend the vast majority of their time, but it’s only part of the picture. You also have to learn important performance skills. Traders should spend as much-if not more-time learning to develop their psychological edge as they do in developing their technical trading edge.

10. Trading is stressful. It certainly can be stressful, and it certainly is stressful for many. It doesn’t have to be. Successful traders have a certain mind-set. They put little importance on any given trade. Their focus is on the long haul. They know that if they attend to the aspects of trading that are within their control (i.e., trade selection, entry, risk control, and trade management) the profits will take care of themselves.

Trader Psychology: The Missing Trade

Traders combat a variety of emotions on a daily basis. Most emotions when trading are unavoidable simply due to the fact that we are human! If we fail to deal with these emotions effectively, it can lead to catastrophic results in our trading. Today we are going to specifically look at the impacts of greed and the frustrations of missing a trade and specific measures we can take to avoid this from happening.

Missing out on a trade can be extremely frustrating and a position that most of us have experienced at one time or another. Primarily this frustration is based in greed as we busily consume ourselves with the pips we “would have made”. By giving into this emotion we often forget that our trading accounts are still intact and we have other market opportunities available. For most traders, if this feeling of greed goes unnoticed it may elicit a response of revenge, in order to “get even” with the market. More often than not this response results in disaster, as a trader may consider taking bad trades not in line with their trading plan or increasing their leverage to quickly makeup for a missed opportunity.

Below we can see a daily graph of the AUDUSD daily chart. Let’s look at the two ways this scenario can be avoided, if price breaks above new highs at 1.0450 on the graph.

Past Performance: Past Performance is not an indicator of future results.

Price Alerts

The first way to help overcome the fear of missing out on a trade is to use price alerts. This is a great tool when you want to see how prices react when they reach an important technical level, such as a support/resistance line, Fibonacci level, or Donchian Channel. Price alerts can be set as audio alerts, or messages through the trading platform or even email!

Entry Orders

Using Entry orders with a breakout strategy is another great way to avoid the feeling that you have missed out on a trade. Entry orders allow us to set a specific price in the market where we wish to execute a preset trading plan. This way, we get to enter into the market on our own terms when the price we select becomes available for trading. Creating an Entry order is an easy process. Select the pair, whether you want to sell or buy and that rate at which you want to do so. You can click the advanced tab to input stops and limits.

Regardless of the method you choose, both price alerts and Entry orders can help traders avoid the fear of missing a trade. When a specific price is reached in the market we will either be notified or ready to execute a preset strategy through pending entry orders. Through this process, what was once seen as a roadblock to our trading success can now be effectively turned into an opportunity!

The Most Important Psychological Skills for Traders

Mindfulness: The Most Important Trading Psychology Skill for Traders

Of all the mental skills a trader can learn, mindfulness is perhaps the most important trading psychology skill.

Mindfulness comes from ancient, eastern traditions associated with Buddhism and Yoga. Although people associate mindfulness with spiritual practices, it is a practical mental skill from which everyone can benefit. Mindfulness is changing the landscape of western psychology. For traders, mindfulness has numerous important benefits.
Exciting Research on Practicing Mindfulness

New scientific research shows mindfulness practice can actually alter brain structure. Researchers studied the brain's gray matter to see whether or not it changed after practicing mindfulness. Those who practiced mindfulness for just 30 minutes a day over 8 weeks had significant changes in the hippocampus and amygdala regions of the brain. These are the brain areas involved in learning and memory, emotional regulation, and perspective taking.

This is the first time research has shown physical brain changes due to mindfulness practice.

What Mindfulness Means For Traders

There are many advantages mindfulness can bring to traders:

We can read the market better when mindful. Mindfulness promotes improved concentration and attention. As the brain research shows, it also improves memory and helps in learning. Traders can help themselves in better reading and understanding the complex patterns and movements of the market by practicing mindfulness.

Reduce emotional trading. Mindfulness helps us regulate emotions. The current research tells us that the brain's emotional center is positively influenced by mindfulness practice. Through mindfulness, we can become inoculated against emotional trading and emotional hijackings – the bane of consistent trading. This is a big plus for traders.

Develop a consistent, accurate perspective. We stay present when mindful. We see reality clearly. Past events (recency bias) or projections about the future are less likely to affect trading. Distracting thoughts that cause poor trading behaviors such as hesitating to take a trade and cutting winners short can become less influential – e.g., "My last three trades were losers; I better sit this one out" (past event) or "This trade looks like it could go against me, I better get out" (projection of the future). Mindfulness can help us develop the perspective that what the mind is saying is unrelated to a trade's expectancy and often unrelated to what ultimately happens in the market.

Developing Your Mindfulness Practice

Start by setting aside 5 to 10 minutes a day; increase the time with practice.

• Sit quietly and simply watch your breath. Pay attention to your belly rising and falling or the air flowing across the tips of your nostrils

• Notice how the mind wanders repeatedly. It will slip into the past or the future. Gently return the mind to the breath and the present.

• Notice how you feel afterword.

How to Manage the Emotions of Trading

Trading is difficult. The goal of this article is not to make trading seem less difficult; but rather to highlight the fact that many new traders can often-times become their own worst enemies, making trading even more difficult than it already is.

To illustrate how this can happen, try to think back to the last time that you were very angry; the last time that you were really mad about something.

Then think about what caused you to be mad.
Then think about what you did, and how you felt after you first became mad.

For many, when they became mad they lost control to some degree; as in – they weren't able to draw upon their highest of mental faculties to 'fix' what was making them upset. This is a trait that can often hinder us from accomplishing our goals.

For traders, this issue can be very problematic.

Imagine you've just taken a trade ahead of Non-Farm Payrolls, with the expectation that if the reported number is higher than forecasts, you will see the price of the EURUSD increase very quickly; enabling you to make a hearty short-term profit.

NFP comes, and just as you had hoped – the number beats forecasts. But for some reason, price goes down!

You think back to all of the analysis you had performed, all the reasons that EURUSD should be going up – and the more you think, the further price falls.

As you see the red stacking up on your losing position; emotions begin to take over. These are often the same emotions we feel if we had just been in a shocking accident, or a fight with another person.

This is the Fight-or-flight instinct, and we have it for a reason.

In psychology circles, the fight-or-flight instinct is often regarded as being a key part of the human psyche; built to protect us in times of stress.

The theory states that when a person encounters stress, their brain quickly makes calculations (so quick that the person doesn't even notice) to make a determination as to how that stress should be handle.

In some situations, when the mind deems the situation as too stressful to attempt to manage – we run.

In other situations, in which the mind feels as though we can make an impact with our actions – we fight.

This is often why we do or say things we regret when we fight with each other; in some cases, it really is out of our control.

This is the fight-or-flight instinct; always part of every one of us constantly seeking to protect us in times of stress.

In trading, we can get quite a bit of stress. When a position begins to turn against us, that's when we begin to feel it. The red arrows on the chart accompany all the fears of failure that rush through our brains in nanoseconds.

As the loss continues to stack against us, that stress becomes more and more profound; making the concept of taking action even more intimidating.

And this is precisely how our fight-or-flight instinct can negatively affect us in trades, as we allow ourselves to make decisions in extremely stressful states that, often-times, don't do us any favors.

The decisions we make in these situations are often called 'knee-jerk reactions,' or 'on-the-fly decisions,' depending on how they turn out. Bad trades are often reactions, while good trades are often decisions.

Professional traders usually don't want to take the chance that a rash decision will damage their account; or said another way – they want to make sure one knee-jerk reaction doesn't ruin their entire career. They often go through much practice, and many trades in an attempt to soften this emotional reaction to the stress of an open trade. Below are some of the ways that can help traders do this.

Plan your success

One of the things that professional traders do to ensure discipline during these trying times is to plan out their approach. The old adage 'Failing to plan is planning to fail,' can really hold true in financial markets.

As traders, there isn't just one way of being profitable. There are many strategies, and approaches that can help traders accomplish their goals. But whatever is going to work for that person is often going to be a defined and systematic approach; rather than one based on 'hunches.'

Planning each trade, and planning how you want to react in each situation that takes place in those trades can greatly help a new traders manage the emotions that come with speculation.

FXCM analysts get to work with many new traders. One of themes we've noticed with those new traders that are successful is the usage of a Trading Plan.

The differences between new traders using a trading plan, and those not using a trading plan were shocking: So shocking that we wanted to produce resources so that any and every trader interested in writing a trading plan would have everything they need.

I wrote an article outlining many of the areas of the trading plan that traders may want to pay focus to.

Compiling a trading plan is the first step to attack the emotions of trading, but unfortunately the trading plan will not completely obviate the effects of these emotions. Below are a few ways that traders will often attempt to mitigate this damage.

See how others handle the stress

In the FXCM series, Traits of Successful traders – our analysts set out to discover what separated those who were successful from those who had failed in the Forex market, and the research was shocking.

In the Number One Mistake Forex Traders Make, David Rodriguez found that, shockingly, retail traders were right MORE often than they were wrong; meaning that they were actually on the right side of the trade more often than not.

But what was even more shocking was the fact that, in many cases, traders were taking losses TWICE that of the gain that they were making IF they were right.

The unsustainability of this type of plan should be obvious. If we're losing 2 dollars for every time that we are wrong, and only making 1 dollar for every time that we are right, we must be right AT LEAST twice for every one time we are wrong.

And that doesn't even include spread, or slippage, or any other costs that may come about.

If we utilize this style of money management, we often need to be right 3 times for every one time that we are wrong; a 75% success rate.

Most professionals don't want to expect themselves to be able to pick the right side of the trade for more than 3 out of 4 times.

And keep in mind, for every one loser that cancels out two winners. So if a trader using the above scenario happens to get surprised – well, now they've taken a loss.

Needless to say, this is a scenario that many traders have a difficult, if not impossible time digging themselves out of.

The thesis of the Number One Mistake Forex Traders Make is:

Traders are right more than 50% of the time, but lose more money on losing trades than they win on winning trades. Traders should use stops and limits to enforce a risk/reward ratio of 1:1 or higher.

Employ loss limits

This may have special importance to scalpers and day traders, but the Loss Limit has been used for years in an effort to prevent a bad day becoming even worse.

After losing trades, we often feel negativity. After many losing trades, this negativity can often build; reinforced by the thought that 'its about time I finally win a trade.'

I can not even begin to count the number of new traders that have come to me, regretfully, after blowing an account on one currency pair in a single trading session simply because they were chasing prices.

What usually happens with these folks is that after placing a few losing trades, and getting nowhere really fast, they increase the trade size.

While there is the chance that the trade might work out for you, the fact of the matter is that you are making quick, short-term decisions about future price movements.

The FXCM Education team places a heavy importance on Money Management, and as we've worked with so many new traders we realized the necessity of loss limits.

In the FXCM Education articles swe offer a full module on Money Management, with a full profile and set of rules for new traders to use.

One of the key elements of our Money Management curriculum is the 5% rule; meaning that on any one trade we will not risk more than 5% of our account.

This rule is in place to ensure that one bad day doesn't end (or cause irreparable damage to) our trading careers.

Lower your leverage

One of the easiest ways to decrease the emotional affect of your trades is to lower your trade size.

Don’t believe me? Remember how it felt the last time you placed a demo trade? It probably didn’t garner much of an emotional affect at all, as there was no financial risk on the trade.

Increasing the trade size, or velocity, will often increase these stress levels as traders are allowing each individual trade to carry to great of an impact to their trading account.

Let me explain.

Imagine a trader opens an account with $10,000 dollars.

Our trader first places a trade for a $10,000 lot on EURUSD.

As the trade moves at $1 a pip, the trader sees moderate fluctuations in the account. Three hundred twenty dollars was put up for margin, and our trader watches their usable margin of $9680 fluctuate by ten cents-per-pip.

Now imagine that same trader places a trade for $300,000 in the same currency pair.

Now our trader has to put up $9600 for margin – leaving them with only $400 in usable margin.

And now the trade is moving at $30 per pip.

After the trade moves against our trader only 14 pips, the usable margin is exhausted, and the trade is closed automatically as a margin call.

The trader is forced to take a loss; they don’t even have the chance of seeing price come back and pull the trade into profitable territory.

In this case, the new trader has simply put themselves in a position in which the odds of success were simply not in their favor. Lowering the leverage can greatly help diminish the risk of such events happening in the future.

Master the Concept of Greed-Free Trading

“Greed has cost me more than anything else.”

“How can I control greed??? That has been my number 1 problem.”

The above two quotes came from emails sent to me from two different traders. I am sure many of us can identify with these sentiments. In the early days of my trading I know I could certainly identify with them! Human nature being what it is, feelings of this type have been felt by virtually all traders at some time or another.
Indeed, the desire to make more and then even more yet is very compelling.

Greed can influence us to enter trades that we never should have entered in the first place. It can make us stay in losing trades too long as well as make us stay in winning trades too long. Greed also plays a big part when we take on too large of a position on a trade in the hopes of reaping huge profits. All in all, it has a truly negative influence on traders.

Here are some ideas that, if put into play, I believe you will find yourself better able to cope with greed.

Have a Trading Plan

By having a clear trading plan that is written out, we know exactly what we are looking for in terms of an entry. Don't compromise. Wait for the precise entry as laid out in the plan itself. Let the market come to you rather than you chasing the market in fear of missing a trade.

The trading plan will also denote the size of the trade you will make along with how you will determine the placement of stops and limits.

By knowing all of these aspects of the trade ahead of time, and sticking to them, you will be less likely to make decisions (oftentimes governed by greed) on the fly. Since we let the trade come to us initially, we start out on our terms. By knowing the size of the trade that we will make (money management) and how much we will risk (stop) and where we will exit the trade (limit), we will go into the trade with a greater level of confidence.

Think of this plan as a blueprint for your trade. Just as a builder would never even consider building a house without a blueprint, as a trader we do not want to enter a trade without our "blueprint" in hand.

Employ the Principles of Money Management on Every Trade

When it comes to Money Management, or the lack thereof, this is an area where greed can really kick in. Traders are very often tempted to put larger amounts of their trading account at risk in the hope of reaping greater gains. They try to do too much (attain outsized profits) with too little (the size of their trading account). This is particularly true when they see a trade that to them looks like a "sure thing".

(Sidebar: There is no such thing as a sure thing.)

As traders we never know when entering a trade if it is ultimately going to be a winner or a loser. As such, in order to protect our trading account, we have to treat each trade as though it is going to be a loser. Just like in driving, we never know if this is going to be the day that we are going to have an accident. Consequently, we must always be on guard.

I am sure you have heard of the term "defensive driving". Think of good money management as "defensive trading".

So we do not get swept away with greed when trading, we need to have an absolute, irrevocable ceiling on the amount of our account that we can place at risk of loss at any one time. The percentage of risk that we recommend is a maximum of 5%. This means that no matter how many positions we have open, if each of those positions were stopped out for a loss, the total loss would not exceed 5% of our trading account.

The next component of Money Management is the Risk Reward Ratio. We recommend a RRR of at least 1:2. This means that if we risk losing 75 pips (our stop) on a trade, would we look to gain 150 pips (our limit) on the trade.

By adhering to these parameters, the 5% rule and the setting of our stops and limits as described, greed can no longer influence our trade. We have put the trade guidelines in place and nothing, NOTHING can shake us from them.

Leave the Trade Alone

Lastly, after the trade has executed with stops and limits in place, leave it alone!! Just let the trade play itself out according to the original parameters you put into place prior to being in the trade when emotions were non-existent.

Think about it…

Before you were in the trade, when you were looking at the charts, checking trends, support and resistance levels, fundamentals and the like, you were totally without emotion. The plans that were put together while in that state of mind were based on facts. Once the trade is entered, however, emotions (greed) can shift into high gear. Making changes to a fact-based, unemotional trading plan based on moment to moment emotional shifts is not a prudent way to trade.

Managing and dealing with greed is not something that will be resolved over the next one or two trades. However, by being conscious of how greed can negatively influence your trading and implementing the above as part of your trading regimen, you will be taking positive steps toward the goal of “greed free” trading.