

Emotion Management System

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ForexHit

■ What Is Emotion Management System?

Emotion management system is the subsystem of the forex trading plan which controls how closely you follow your trading system and your money management system. The control is executed through the weakening of the **destructive emotions** (those that force you to deviate from your systems) and strengthening of the **beneficial emotions** (those that force you stick to your systems). That is, emotions which make you deviate from your trading system or your money management system are weakened and those emotions that encourage the strict adherence to these two systems are instead strengthened.

The premise of the emotional management system is that **each type of emotion uses a portion of a limited reservoir of mental energy that should be carefully protected against wasteful uses**. An emotion is, in essence, a form of **mental leverage that turns ideas into actions**. Because this storage of mental powers tends to be limited it should be used carefully - without becoming too attached to or "invested in" - your trades (in the same manner that the leverage is best used sparingly), so that no single trade can hurt you emotionally - because the outcome of any single trade is almost always random. It is best to use this energy for the implementation of your trading system and money management system (which are simply computerized expressions of your analytical abilities or another professional forex trader) than for the implementation of your subconscious fears (which are often inappropriate defensive mechanisms derived from your past experiences). Below is the description of destructive and beneficial emotions along with the techniques which can be used to manage them.

Quote: "Management of one's emotional state is critical. The truly exceptional traders can stand up to anything. Instead of getting emotional when things don't go their way, they remain calm and act in accordance with their approach." Charles Faulkner, in Jack D. Schwager's book "New Market Wizards".

■ Destructive Emotions

One of the strongest destructive emotions is **fear of losing money**. This fear comes from the internal programming that the money is limited and very important commodity. Most people, during the whole of their lives, learn to associate money with various types of tangible (e.g. property, luxury objects) and intangible rewards (e.g. security, prestige, feelings of self worth). Through this process of association money starts to symbolize deeply ingrained notions of prosperity and freedom. So strong is the association, that any "attack" on the capital base (e.g. by a sharp currency price movement against an open position, or a series of losing trades) is likely to trigger the defensive mechanism in the form of fear to protect the embodiment of so many notions of well-being. This fear can lead to the **premature exit** of a profitable position - that is before the exit signal is generated by your trading system. It can also **force you to not take a signal after a series of losing trading signals** or to open position **smaller in** size than that suggested by your money management system.

The **twin brother of fear is greed** which arises from the same programming towards the money. The greed can manifest itself in tempting you to **hold a position longer than dictated by your trading system** - that is beyond the time the exit signal is generated. The greed can make you **open a position when there is no entry signal from your system** (in which case it would only be the fear of losing a trading opportunity). It can also lure you into **greatly increasing your position size** after a long series of winning trades - in direct violation of the parameter set by your money management system (percent risked). The pride is similar to the greed in that it forces the trader to commit the same digressions from their trading systems.

To overcome fear and greed all that required is to **remember that you are not fishing for all trading opportunities**. It would be extremely dangerous to try to take advantage of any profit opportunity that arises - because no system or trader can **consistently** capture all trading opportunities. You are aiming not for the quick profit but for consistency in system performance and with it for the **confidence that you will achieve your profit objective** if you strictly follow your system. Your backtesting will also show you that as long as you follow each signal from your trading system and every instruction from your money management system you will achieve your profit objective sooner or later (provided that your system has a positive expectation). It also pays to keep in mind that your systems are only the extension of your pattern recognition abilities. So if you ignore any of your system instructions you are in effect saying that you do not trust yourself - which is a sure sign that you should not be trading currencies.

I have found that forex trading simulator (Please note: The size of this page is 0,6 Mbs and it requires that you have Flash installed and Javascript enabled in your browser)- through its ability to model entirely random trading outcomes - can be of great help to traders and investors who find it difficult to accept that winning systems can go through long losing streaks. If you model a few trading scenarios you will quickly see that systems with positive mathematical expectation tend to turn out profitable in the long run (after 100 trades) - even if they can go through a few losing streaks in the short run. The calculator is also good for reminding traders who sometimes overtrade that any long winning streak is always followed by the losing one - therefore, it pays to keep your positions size within the limits set by your money management system. All in all, **forex trading simulator can be very useful for preparing yourself psychologically for the trading of mechanical trading systems in general** (not discretionary systems - because you cannot backtest them to calculate their accuracy and payoff ratios)

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