Lesson 2 by Madiba Malebo

Trading psychology

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3 M's
The Pyramid of Success

3 M's - The Pyramid of Success

Most Successful traders agree:
Successful Trading or Investing Requires :

1. Method - A working system

2. Money Management - Sound money management practices

3. Mind - Proper mental approach

Without any one of these key elements, you'll ultimately fail in these endeavors.

3 M’s - Method

Method can be called the usage of :

- Technical Analysis
- Fundamental Analysis
- Market Rumors
- Gut Feeling

3 M's - Money Management

Money Management can be called the usage of :

- Specific Amount of Money used in each Trade
- Stop Loss Order placed in each Trade
- Amount to risk in each Trade

3 M's - Mind

Mind can be called the usage of :

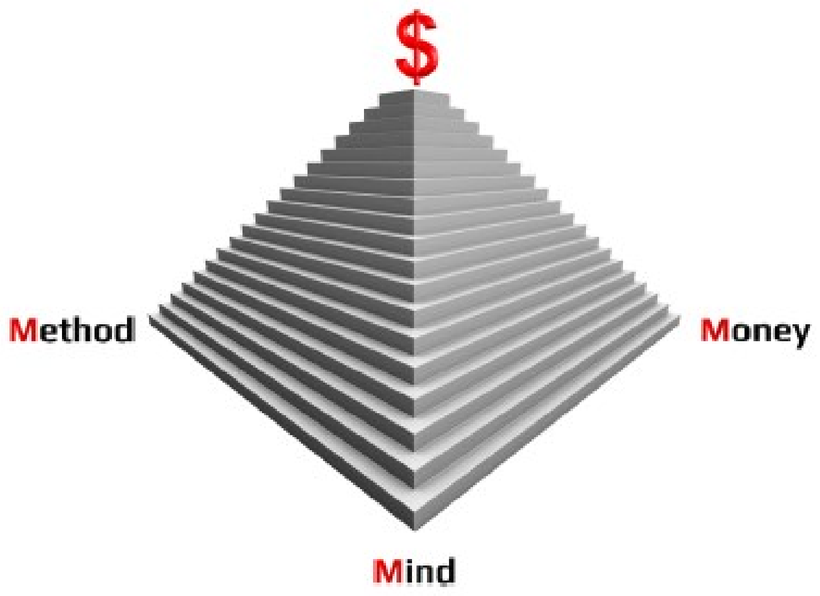
- Control on Trader's Fear
    - Control on Trader's Greed
        - Trader's Discipline in general

3 Agreements

- Technical Analysis is 100% correct
- Technical Analysis does not work in Forex
- If you know everything there is to know about Technical Analysis, you will make millions.

- What You Need is the 3 M's

3 M's - The Pyramid's Cornerstones



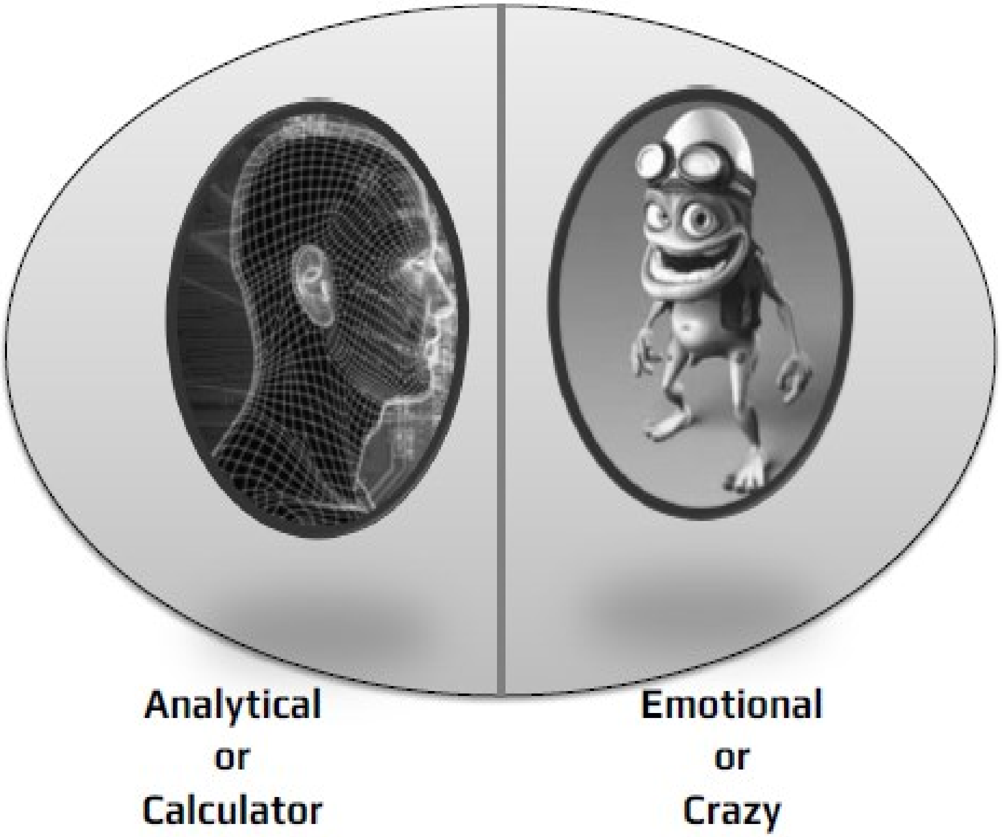
Why we Trade

Trading is the most exciting activity that a person can do with their clothes on. Trouble is, you cannot feel excited and make money at the same time.

Think of a casino, where amateurs celebrate over free drinks, while professional card-counters coldly play game after game, folding most of the time, and pressing their advantage when the card count gives them a slight edge over the house.

To be a successful trader, you have to develop iron discipline (Mind), acquire an edge over the markets (Method), and control risks in your trading account (Money).

The Human Mind



Psychological trading issues and their causes:

Fear Of Being Stopped Out Or Fear Of Taking A Loss: The usual reason for this is that the trader fears failure and feels like he or she cannot take another loss. The trader’s ego is at stake.

Getting Out Of Trades Too Early: Relieving anxiety by closing a position. Fear of position reversing and then feeling let down. Need for instant gratification.

Adding On To A Losing Position (averaging Down): Not wanting to admit your trade is wrong. Hoping it will come back. Again, ego is at stake.

Wishing And Hoping: Not wanting to take control or take responsibility for the trade. Inability to accept the present reality of the market place.

Psychological trading issues and their causes:

Compulsive Trading: Drawn to the excitement of the markets. Addiction and Gambling issues are present. Needing to feel you are in the game.

Anger After A Losing Trade: The feeling of being a victim of the markets. Unrealistic expectations. Caring too much about a specific trade. Tying your self-worth to your success in the markets. Needing approval from the markets.

Excessive Joy After A Winning Trade: Tying your self-worth to the markets. Feeling unrealistically "in control" of the markets.

Limiting Profits: You don't deserve to be successful. You don't deserve money or profits. Usually psychological issues such as poor self-esteem.

Psychological trading issues and their causes:

Not Following Your Proven Trading System: You don't believe it really works. You did not test it well. It does not match your personality. You want more excitement in your trading. You don't trust your own ability to chose a successful system.

Over Thinking The Trade, Second Guessing Your Trading Signals: Fear of loss or being wrong. Wanting a sure thing where sure things don't exist. Not understanding that loss is a part of trading and the outcome of each trade is unknown. Not accepting there is risk in trading. Not accepting the unknown.

Not Trading The Correct Position Size: Dreaming the trade will be only profitable. Not fully recognizing the risk and not understanding the importance of money management. Refusing to take responsibility for managing your risk.

Psychological trading issues and their causes:

Trading Too Much: Need to conquer the market. Greed. Trying to get even with the market for a previous loss. The excitement of trading (similar to Compulsive Trading).

Afraid To Trade: No trading system in place. Not comfortable with risk and the unknown. Fear of total loss. Fear of ridicule. Need for control.

Irritable after the Trading Day: Emotional roller coaster due to anger, fear, and greed. Putting too much attention on trading results and not enough on the process and learning the skill of trading. Focusing on the money too much. Unrealistic trading expectations.

Psychological trading issues and their causes:

Trading With Money You Cannot Afford To Lose Or Trading With Borrowed Money: Last hope at success. Trying to be successful at something. Fear of losing your chance at opportunity. No discipline. Greed. Desperation.

Psychological trading issues and their causes:

These are by no means all the psychological issues but these are the most common. They usually center around the fact that for one reason or another, the trader is not following their chosen trading approach or system. And instead prefers to wing it or trade their emotions which in trading will always get you in trouble. So, I think you can see how psychology is all important in trading.

Our goal as traders in regards to psychology is to maintain an even keel so to speak when trading. Our winning trades and losing trades should not affect us. Obviously we are trading better when we are winning, but emotionally we should strive to maintain an even balance emotionally in regards to our wins and our losses.

Accepting losses:

The first reason traders lose may seem obvious but in reality it stems from long term social conditioning. It's their inability to ACCEPT LOSS. Losing generates powerful emotions, such as fear, uncertainty, apprehension, and self-doubt especially with men.

Men are socially conditioned to succeed from the time they enter the world. They are guided to be become achievers. Influenced by family, friends, education, and career environments they are encouraged to seek professions of Doctors, Lawyers, and Bankers.

Striving to be right, number one, the breadwinner, and the best, always seeking perfectionism. They are socially conditioned to be the family providers. Add to this various cultural pressures and demands and men have a built-in fundamental obligation to succeed.

Accepting losses:

The solution is to take a reality check. LOSING is part of the game. Its possibility never goes away. Bottom line, traders lose. The key is, how much and how often, separates the great traders from those who will always struggle.

One can learn to accept losing by redefining the meaning of loss. If you define or equate it to failure then it will take its toll on the bottom line but redefining it is a way to move forward, a way to improve trades and make losing OK.

Look at losing as a good thing that will improve a trade. Find something new. Make the mistake a "blip" on the radar and let it come and go with ease, no big deal.

Locked patterns:

The second trading challenge is the innate human characteristic of "patterns."

Here is an example of a trader with a locked in pattern.

He continually does the same mistakes when trading. When asked to describe the mistake he will do it in detail. When you tell him don't do it again he says he cant.

They intellectually know they should stop but they can't and they repeat the same problem over and over and repeat the loss over and over.

Locked patterns:

- You go long and the market immediately goes down.
- You go short and the market immediately goes up.
- You start shaking - you start sweating - you can't breathe.
- You are ready to throw your computer out the window
- And jump out right after it.
- AND the market has only been open for 30 minutes.

- What is going on?

- You are in a trading psychology spiral

Breaking a Pattern:

Getting up and moving is the fastest way to stop a pattern.

- Take a walk and then come back.
- Check if you followed your system.
- See if your system needs improvements and make them.
- Stick with your system - days like this happen.
- Trade smaller amounts until you make profits again.
- It’s important to avoid bad repeat patterns at all cost. Do whatever it takes to break them.

Breaking a Pattern:

What's the solution to breaking a pattern?

It's critical to notice when the pattern is happening and to never let it take hold. Attacking a loss immediately helps this.

If you have 3 trades exactly alike and they are losers you have to make it a MUST to examine them and change the approach. If you don't the probability of repeating it and losing again is VERY, VERY high. A trader must do whatever it takes to stop.

Blocked Emotions

Finally the biggest most dangerous of the three problems is EMOTION.

When a trader experiences emotion at anytime during the trade they can not think clearly, because the emotion is stronger. So they react in the wrong way. Emotions will cloud judgment and prevent a trader from being creative because the mind can not allow normal thought to occur. Emotions over-ride logical thought.

Here is how you know you have an emotional block. If you want to trade a certain way and react a certain way but can't and are "pulled" to react differently even though you intellectually KNOW you want to do, you have a block.

Locked Emotions

Our emotional strengths and “peak’ mind-set come from how we think and what we think about. If you put bad things into the thought process you get bad things out, put good things in and you get good things out.

Finally the best way to remove emotions in the moment is to ask the mind a good question. Questions force the mind to release the emotion, as it shifts to finding the answer to the question

It’s important to also remember, should you not be able to control what your doing, most likely there is a strong block taking over. In that case you will need additional help to release it.

Reminiscences of a Stock Operator (1923)

Your biggest enemy, when trading, is within yourself.

Success will only come when you learn to control your emotions. Edwin Lefevre's Reminiscences of a Stock Operator (1923) offers advice that still applies today.

1.Caution

Excitement (and fear of missing an opportunity) often persuade us to enter the market before it is safe to do so. After a down-trend a number of rallies may fail before one eventually carries through. Likewise, the emotional high of a profitable trade may blind us to signs that the trend is reversing.

Reminiscences of a Stock Operator (1923)

2.Patience

Wait for the right market conditions before trading. There are times when it is wise to stay out of the market and observe from the sidelines.

3.Conviction

Have the courage of your convictions: Take steps to protect your profits when you see that a trend is weakening, but sit tight and don't let fear of losing part of your profit cloud your judgment. There is a good chance that the trend will resume its upward climb.

Reminiscences of a Stock Operator (1923)

4.Detachment

Concentrate on the technical aspects rather than on the money. If your trades are technically correct, the profits will follow.

Stay emotionally detached from the market. Avoid getting caught up in the short-term excitement. Screen-watching is a tell-tale sign: if you continually check prices or stare at charts for hours it is a sign that you are unsure of your strategy and are likely to suffer losses.

5.Focus

Focus on the longer time frames and do not try to catch every short-term fluctuation. The most profitable trades are in catching the large trends.

Reminiscences of a Stock Operator (1923)

6.Expect the unexpected

Investing involves dealing with probabilities, not certainties. No one can predict the market correctly every time. Avoid gamblers� logic.

7.Average up - not down

If you increase your position when price goes against you, you are liable to compound your losses. When price starts to move it is likely to continue in that direction. Rather increase your exposure when the market proves you right and moves in your favor.

Reminiscences of a Stock Operator (1923)

8.Limit your losses

Use stop-losses to protect your funds. When the stop loss is triggered, act immediately - don't hesitate.

The biggest mistake you can make is to hold on to a losing position , hoping for a recovery. The markets have a habit of declining way below what you expected them to. Eventually you are forced to sell, decimating your capital.

Reminiscences of a Stock Operator (1923)

Human nature being what it is, most traders and investors ignore these rules when they first start out. It can be an expensive lesson.

Control your emotions and avoid being swept along with the crowd.

Make consistent decisions based on sound technical analysis.

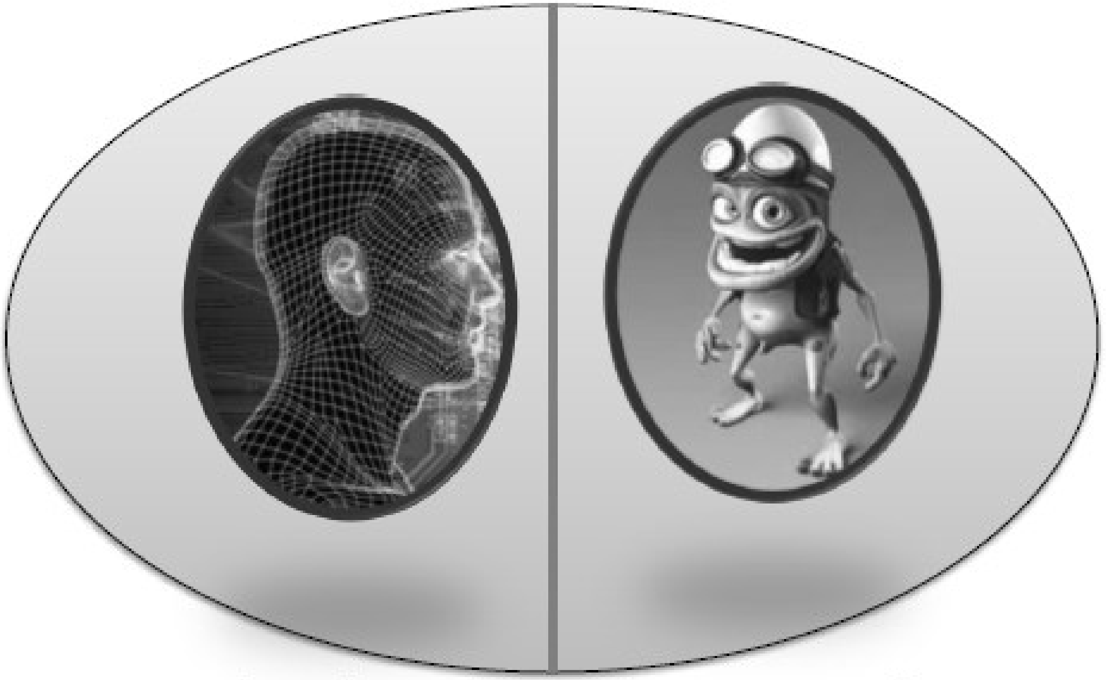
Be Cool

Markets change, new opportunities emerge and old ones melt away. Good traders are successful but humble people –they always learn.

Speculators get paid for buying what nobody wants when nobody wants it and selling what everybody wants when everybody wants it.

Remember there is no such thing as a bad trader. There is only a well trained or badly trained trader.

The Human Mind



Analytical
or
Calculator

Emotional
or
Crazy

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