EP113: Signs That “You Got It” (Part 1 of 2)

Darren: If you are feeling completely comfortable with everything then you've got to expect lower returns...

Announcer: Two Traders, Darren and Walter, pull back the curtain on profitable trading systems, consistent money management, and profitable psychological triggers. Welcome to the Two Traders Podcast.

Walter: Welcome to Two Traders. It's Walter here. Hello, Darren.

Darren: Good afternoon, Walter.

Walter: Darren, today we're going to talk about this concept, this idea of as a trader, how do you know when you've got it right? What does it mean? How do you know? What does it feel like? What do you point to and say, "Okay, I've got it now." Or, maybe you're really never there.

Darren: Yes. It's a good question, isn't it? I think when we start our trading, we have this notion that when you have got it, you will know without certainty that you've got it. I think when you're trading, you constantly got this sort of internal battle going on where you're always, to an extent, questioning what you're doing or your strategy because you're always seeing that, "Oh, if I have just applied, had a different money management strategy, then I would've made more money."

There's always better outcomes that you could've got. I think we have this notion that all of that is going to go away and there's going to be this blissful calm where you're just trading in a mechanical, almost like sort of zen, but it's all like a Jedi Knight and it's soldiers kind of smooth.

I don't think that happens really. I was certain it hasn't for me but you just...

Walter: I'm sorry, it's just so funny. You're right. Go on, keep going.

Darren: ... But you just get to a point where you get better at knowing the elements that are worth worrying about and not. You don't make so many bad reactions to the normal to's and fros of a trading strategy. You don't react so badly to losers and things like that.

There's a good quote by Mario Andretti. Have you heard of him, Mario Andretti?

Walter: The race car driver, yeah.

Darren: Yeah. He said that if you feel comfortable, you're not going fast enough. No. If you feel completely in control, you're not going fast enough. I think that's the thing. If you ever

get to the point where you're completely comfortable and at ease and you feel like you've got it, then you're probably not pushing yourself enough.

You're probably not performing to your optimal so you get more used to the pain of trading and you get better at dealing with it but I don't think you do ever know for sure that you've got it.

Walter: Yeah, it's a fair point. The only reason I was chuckling was because I agree. I think with changes and I think why we don't feel like we haven't really got it or reached it or hit the spot is because we are always moving the goal post.

In the beginning, thinking back I thought that -- and I think this is very common. I don't think that I'm unique in this aspect which is I thought that -- if you're a good trader that meant you won more than you lost. Everything was on the win rate.

I think what happens over time is, what happens is your focus or what you would define as successful or excellent trading or whatever, I think that changes. I think that's kind of, listening to what you were just saying, I think that's how I interpret it. That's obviously my filter, my point of view.

For example, like right now you're talking about like you're in this blissful state of just accepting whatever the market throws your way. I think that's one of those things that comes up.

First, we want to be winners. We always want to win, we want to win more than we lose. Then, maybe we want to be able to remove those crazy things that we do like letting a losing trade turn into a massive loser or try to extract revenge after we have some losing trades or whatever.

Then, later on you might think, "Well, I just want to be able to trade and not have to stay in front of the screen all night and not getting sleep" or whatever. I guess, what I'm saying is we define success in different ways as we advanced as traders.

I suppose you would do that in life as well. What you would consider to be successful when you're 21, is probably going to be very different when you're 71, but I don't know.

Darren: It's difficult as well, isn't it? To sort of everyone is going to determine whether they've got it in a different way, as well. I'm sure most traders who start trading something like Martingale that have had 6 consecutive winning months and they've got a beautiful looking equity curve.

The world imagined that they've got it. I suppose, really, all you can ever get is good probabilities of longevity and that's all that you should be aiming for. Although, again, what people want to get out off trading varies massively as well.

Walter: Let me ask you something. Have you ever traded Martingale before? Did you ever trade that?

Darren: No. I've never been drawn to it because it instantly appears to be wrong to me.

Walter: Yeah.

Darren: Instinctively, when I came to trading, win rate was never something that was a lure for me so, no. Martingale never appealed to me.

Walter: I was talking to a like, I don't know, you can call him like a performance coach or whatever and he was talking about trading and I was explaining to him what traders go through and stuff like that. He made this off-hand comment, "As long as you win more often than you lose".

I think that's the assumption. If you're a trader, you just win more often than you lose. It's interesting that, I think I've talked about this story, when I was at University, a good friend of mine, who actually ended up getting me into trading later on in life, he was basically running like a Martingale strategy with blackjack.

He would walk around with his... He had like 7 blackjack, 7 cards decks that he carried around with him and he would always playing blackjack by himself, like with himself. He was trying to workout. I guess, it's a sort of a caveman's style of Monte Carlo study where he was trying to workout how many consecutive losers would he have.

And then, we went to our Statistics Professor and we said, "What about this?" and he's like, he looked at us like we were crazy. He's like, "That's the gambler's fallacy," which is the bedrock of Martingale.

The gambler's fallacy being of course, this idea that if you have so many results of something then the other side is more likely to happen. That's why they have in roulette tables, a lot of casinos will have the numbers that have come up so you can look up there and can say, "Oh, it's landed on red 10x in a row, it's definitely going to land on black next time." Not really.

So, you're never drawn to that? That's interesting. So you just thought that's a losing, that's just not going to work?

Darren: Yeah. I think when I first got into trading, the first thing that clicked with me was the idea that the simple sort of cornerstone of if you win more on your winners than you do on your losers, then you don't have to win that often.

That just instantly made sense to me. That was the one idea that's always made sense to me and that's probably why it's still the most important part of my trading. When you go on from that, you'll realize that isn't the only way to make money.

I think when you say when you've got it, it's the case of like understanding what the probabilities are, that's what it means. If you understand the probabilities, then you stand a good chance of making some money consistently.

If you think about something like the Market Wizards book, not all of those traders in the Market Wizards have continued success since they were in those books. Some of them have gone on to lose a lot of money. I imagine all of them, we would assume, had got it so it was never that certainty.

Walter: I agree. You bring up exactly what I've, like my next question was, what is the thing that you would hang your hat on and say that that means you've got it? You've just mentioned probabilities and understanding probabilities.

To me, the thing that I've been working on a lot is trying to let go and trying to understand that it's okay whatever happens. In other words... Let me explain it in a better way. I guess, to me, as a trader, I don't want to say you've got it but it's something like that.

You're doing well when you are at the point where you keep chopping wood no matter what's happened. In other words, like if I'm trading a really low win rate strategy, I have to be okay with the fact that I might only win 22% of the time.

If my math is right, 78% of the time I'm losing, right? To me, you've got it when you're able to keep taking the trades without second guessing yourself when you know you're only going to win 2 out of 10.

Darren: Yeah. And, I find it in the end, when you've done that for a while, I find that comfortable to do than thinking I've got 78% win rate so really I should be winning every trade that for me is.

I know, essentially, that sort of two sides of the same coin really but I certainly find that easier because whenever I'm in a trade, I pretty much expecting it to lose. And then when you've got a winner, it's like, "Oh, that was nice." It was massive as well which is even better.

Walter: Yes. You would make a good... You've heard about this study about how the Danes are the happiest people in the world?

Darren: Yeah.

Walter: The reason why is because they've got low expectations.

Darren: Yeah and that's important. They need to be realistic expectations as well.

Walter: To me, that's what it sounds like when you say, "I'm going to go and take this trade. It'll probably going to be a loser" and "Woah, that was surprising. It worked out all right"

Darren: Yeah. It's how you kind of reframe it and look at what you're really trying to achieve. If you know you've only got hit one winner out of ten trades, just luck can get you there. If you hit two winners out of ten trades and you're making a big profit, then that's an easy burden to trade with.

I know for a lot of people, it's the complete opposite they prefer to do. But, I think also when people think about a state where they believe they've got it and they can finally relax about trading, I think deep down, psychologically, what they're looking for is a state of no uncertainty.

"This is my strategy, it works. It makes a lot of profit and it's always going to work." We kind of want the certainty in all levels. And then, "Okay, we've got it now." But again, that's just unrealistic.

If you'll listen to the traders who've been around for a long time in the Market Wizards, they're always refining. They're always tweaking. They're always looking at new models. They're completely at ease with the fact that they could trade some market condition for a long period of time.

And then something could change which means that that particular model doesn't work anymore but they get that deep understanding about probabilities. The fact that there's a lot of opportunity in trading and just because a certain model stops working, then it doesn't mean you're not going to be able to find a new one.

It's about mindset in where you believe edge is really are in the market and I think some of us think just like a particular equation that works and that's going to work forever, that is just not the way it is. I don't believe it anyway.

Walter: What I'd like to know, Darren, is why do you think it is that these traders such as the Market Wizards or you, or me or whoever -- the listener here -- is interested in validating new models or tweaking models?

Is it because the market always change and you must do that to stay ahead of the curve? Or, is it just because trading is interesting to you or I or whomever and that's why we like to fit it all around with trading systems?

Darren: I think it's just human curiosity, as much as anything.

Walter: Agreed.

Darren: I think they just enjoy doing it, don't they?

Walter: Exactly.

Darren: They enjoy looking for this little, "Oh, look Friday close on the S&P 500 and if I enter there..." I think there's much for the curiosity as anything and the fact they enjoy it. I think all of those traders... Let's keep talking about the Market Wizards.

I think if you went to all of them and said, "Can you trade a random entry and make profit?" They'd all agree and they'd be able to give you a good explanation why. They all fairly have a deep understanding of probabilities to do that.

And then for those looking for models that work, they're just looking for little edge to use that probability model in. Again, some of those things can just be for psychological reasons as well.

"I can't be trading this trend trading strategy..." Where you something to indicate the long term trend and then you go to a lower time frame to enter in the direction of that trend.

The interesting thing is if I completely take the long term trend element away, it makes more money but, when you come to trade it manually, psychologically it's way more challenging.

I actually trade it with this long term trend indicator in place knowing that it doesn't actually add any edge. It actually means it makes less profit but in every day that I get up and trade, it's just easier for me to do.

Walter: Yeah. That's like having a target and having a trailing exit on the same trades. Putting your position, you actually make more money if everything is set to the trailing exit because you have an unlimited profit potential but psychologically unknown, it's easier to handle having a trades put that way so that's why I do it. It's the same thing.

Darren: You could argue that looking for technical models, edges, in the market is more of a psychological thing than anything. I think those edges are so slim. They're slim, those edges. It's those other elements that are really going to pay dividend.

Walter: Absolutely. I think that's probably, you're hinting at some of the Market Wizards, how they've changed or lost millions and bowed out of trading or whatever. I believe that part of it may just be that they are unable to withstand the drawdown.

I'm thinking specifically about Richard Dennis. Now, Richard Dennis who was along with William Eckhardt the guys that put together the Turtle, the famous Turtles experiment -- with the Turtles -- and they're interviewed in the Market Wizard books as well.

My understanding is that years after the first Market Wizard book, Richard Dennis was in a horrible drawdown and he had lost a lot of investors in this sort of thing. I remember reading an interview where he was saying, "Basically, yes we've had some drawdowns. We realized that a lot of people are trading the end of day trend trading system like we are so what we've decided is that you need to move to a different time frame. You need to go either really, really lower time frame or really, really high time frame but the D1 wasn't really working anymore."

Basically what he was doing is, he's switching his strategy up. Now, I contend that he probably... One of two things was happening. Either, psychologically, they just couldn't handle having that drawdown, that extended drawdown and all their clients pulling their money out.

And, or they had too much risk on so that that made the drawdown worst than it should have been. Instead, if they've probably just kept chipping away, they've probably would have pulled out of it.

Maybe they're just unable to withstand that psychologically. Which is kind of what I was talking about before about the big thing I'm working on is being able to keep chipping away even though you know you're going to lose. Most likely event is, it's a loser.

So, what do you think about that? I mean, do you think that, that's a possibility because everytime I think of Richard Dennis, I think that I can't help but to think that maybe that's what is going on there.

He just couldn't handle it psychologically so he was looking for reason, he's grasping for that and the reason was, "Oh, the markets have changed." How do you know it wasn't just a normal sort of an extended deep drawdown?

Darren: Yeah. His pain threshold basically and that was making the decision for him. I've seen that myself like the version of my strategy that really make amazing returns, the pain threshold is too much.

I find that a lot of the rules I put in place are just sort of deal with that pain rather than they're being any great technical advantage in them. Specially if you've got clients that you're trading for and they're pulling out, that's going to take psychological impact on you as well.

Walter: Yeah. And isn't it interesting, the guy from the Big Short... Was it Burry? Was that his name? Dr. Burry?

Darren: Yeah.

Walter: Because he was so convinced that he was right, even though he was in the deep drawdown and even though his clients were threatening to sue him and pull their money out and blah, blah, blah. Michael Burry, he was so steadfast.

That could work both ways. That could be one of those things where you should be someone humble because the market can definitely either way, your account for a long, long time, no matter how steadfast you are in your position. That's not necessarily maybe the best way to approach it and that was the way he did.

It was very different. To me, that was a very different approach to what Dennis took. I don't know how many years or how long Dennis was in drawdown before he decided to switch up his strategy.

Maybe he was going to do it anyway, I don't know, but it's interesting to me that he sort of succumb to the pressure and Michael Burry didn't.

Darren: Yeah, I know. I notice this with fund managers. They've kind of either go one way or the other. And, Dunn, he says to his investors, "I'm not going to explain anything. I'm doing it this way. If you don't like it, take your money out."

Instantly, he doesn't have a great many investors even though his returns are really good and then you get someone like Tom Basso who says, he listens to what his clients want and that for him, that is his job as a Fund Manager.

To give his clients what they want and he has much more modest returns but tends to go through less pain. I think as individual traders, that's a difficult decision that we have to make really.

Do we want very little pain then you're going to get modest returns. And, if you prefer to sit through much more pain and bigger drawdowns then you're in a better chance of getting those big returns.

I think sometimes you want to be in both camps and that probably is the worst place to be. You want to be able to be in one or the other....

Walter: Unfortunately, that's all the time we have for this episode but in Part Two, you'll hear Darren talk about the importance of pain in your trading. You'll also get the Lesson of the 43 Million Trades and how you can use that lesson to improve your trading.

All about the Big Five and why an errotic trader have an advantage so that's a little bit of Psychology there. Also, why traders diversify, Darren talks about this and the Two Traders talk about one of the easiest ways to create an edge in your own trading.

All of these and more in Part Two. See you next time.