EP117: Trading Negativity

Darren: And I don't think it's down to us as traders to make the world a moral or immoral place. We don't really have that control, do we?

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 the Two Traders Podcast. It's Walter here and I've got Darren on the line. Hello, Darren.

Darren: Good afternoon, Walter.

Walter: Darren, we were just talking about this right before we hit the record button for today's episode and I'm wondering about your thoughts. I have some thoughts on this but there was an interview a few years ago from a gentleman in London.

I think his name is Alessio Rastani -- I'll put the **interview in the show notes** for everyone -- but he was talking about... They were interviewing him on some financial channel or whatever.

He was an independent trader in London and he basically said that he was dreaming of the next GFC. That he couldn't wait and every night he goes to bed wishing for another GFC.

The question is, for today's Podcast -- and the reason why this is pertinent to me is because I've heard these rumors. We're recording this on the second of November 2017. I've heard these rumors that there is something really crazy that's about to happen and it's going to send a shock to the market.

Whether or not this comes true, we'll find out in the future but the idea is: is it moral or should you want to try and profit from terrible things that happen in the world? What are your thoughts?

Darren: It's difficult really, isn't it? As traders, essentially, your ways of trading could lead somewhere against bad news somewhere else. You could argue that we're going to profit enough other people's misfortune.

I suppose if someone wins a trade then somebody else is going to lose a trade and generally there's more losers than there are winners in that. You could argue that morally, it's wrong.

Certainly, it would be wrong to wish hardship on other people, I suppose. But, I don't think as a trader you can consider yourself being immoral because of that. It's a difficult question, really.

Walter: Yeah. I mean thinking about what I... Like when I look at the charts, what I look for is volatility. And so, volatile markets get me excited and volatile markets are the ones that I typically will find the trade.

And so, with that comes some sort of news generally speaking. You can point to the volatility and say, "Well, that's because so and so said this or whatever." But then again, it's the reaction to that. Just because there's volatility doesn't necessarily mean that it's bad news. I suppose you could have good news for just about everyone.

Here's an example that I remember from a few years ago. There were some news that it affected the NZD and the news was... It was early in the week. I think it was a Monday in Asia.

Right when the market is open for the week and there's some news that came out of New Zealand about the fact that China wasn't going to buy the New Zealand milk for some reason like it may have been tainted, or expected to be tainted or something.

The dairy business is a big business in New Zealand so the NZD fell. In some ways, I mean that's bad, right? The dairy industry is being affected by China's stance on "We're not going to import New Zealand milk." But then, the traders were shorting the NZD. We're happy because their positions magically moved into quick profit or whatever.

I mean, it's kind of like one of those things where I feel like if I'm looking for volatility in the markets -- and I suppose some traders don't want volatility. There will be some that really like low volatility markets and they're looking for the market to stay constrained and they use those borders as places to contain their risks.

That makes sense but I'm looking for that. I mean, I don't know if it's possible to have news that creates volatile movements in the market that's kind of good all around. I don't know.

Darren: Yeah, probably not really. The other argument I hear a lot about trading is that we don't actually contribute anything to society. We don't actually produce anything. It's just money is just kind of passing from one person to another.

It's not actually improving the world we live in. But, I guess with a lot of stuff in life, you kind of have to accept that and try and make up for in other aspects of life. Certainly, it doesn't keep me awake at night thinking whether I'm being a good person or not because I'm a trader.

Walter: Yeah. I completely disagree with that and I've heard that quite a bit as well. I think that the way that I see it, it's the people who are speculators in the market are sort of like the oil in the engine that lubricates the machine.

If you don't have enough of them in there then you're going to end up with one of those markets where there are no real smooth price movements. It's really choppy and things kind of ratchet up and ratchet down.

We've all read stories for example like the Market Wizards. I think there was one interview where one of the Market Wizards was saying that he was in a limit, in a lock limit. He was in a position in the future's market.

And apparently, I don't know if this is still true but apparently there is a rule that if the market goes down a certain amount then it is like that's it for the day. He's not going to trade anymore.

Like it's kind of locked, they call it lock limit. It can only go so far and then it's locked there which basically means you can't get in or out of any of your positions. He was talking about like ten days in a row, the market was at lock limit on the opens.

He was stuck in this position and he was underwater and everyday he was waking up hoping that he could get out of it. He couldn't. Well you see, that's the risk that we take as traders.

We take a risk if you were in a position and then the Swiss National Bank on January 15, 2015 makes a surprise announcement. Guess what, you get wiped out. You're the one taking the risk as the speculator and you're the one that's greasing the wheels.

Now obviously, the real lubrication for the foreign exchange market is through the banks. The banks are the ones that are doing that. But the point is that, if you didn't have speculators in the market you would always have a situation where the prices would move herky jerky.

The more people participating in the market, the smoother the charts look. To me, that is the attraction to Forex is that we have these really beautiful charts. You don't have so many gappy movements that you see in a lot of share markets. And so, I like that from a technical trading point of view.

That's what I like about the beautiful looking currency charts. I don't like the ones that are really choppy and gappy and herky jerky. That's what we contribute to the market. I see it as that.

I understand why people say that and claim that you don't add anything to the market. But, if I'll go to a Psychologist and I sit with a Psychologist and the Psychologist gives me a 60-minute session and at the end of it I think, "What did I just pay you 250 bucks? I don't know feel any better."

I mean, do that Psychologist not know anything to the market either? You know what I mean? You can make that argument about a lot of things, I suppose.

Darren: Yeah. What do you think of this idea that essentially, specially with currencies, that it's already decided where the price is going to be in six months time. The Central Banks have already like agreed, "This is where we're going to set the USD and no matter what anybody else does or what the news is generally in between." That's where they're going to put it. Do you agree with that or not?

Walter: No. I think that's ascribing too much power too. Like I mean, in Australia there's a lot of talk about the Reserve Bank of Australia which is the Central Bank says that, "We want the dollar here. We'd like to see it down here." And for months and months and even years that the AUD didn't fall to the point where they "wanted it".

I think we're giving them more credit than they have. For example, the classic example is the Bank of Japan. You can go back on the bank, on those JPY charts, especially, between 2005-2010 and you can see where the Bank of Japan was selling JPY and buying EUR and they wanted that chart to go up.

Okay, they wanted the EUR/JPY to go up. They wanted the USD/JPY to go up. In other words, they wanted a weaker JPY. They wanted cheaper exports and tell you what? They spent a lot of money trying to get that to happen. And you know what happened every time?

Darren: It's not strike back on that.

Walter: Yeah. I mean you've seen it. I mean, I know you've seen it. I remember seeing it. I'm like, this is crazy. They're just throwing money and so to me that's just a classic. The market will go where it's going to go.

I mean I think in the short term, maybe you can affect it for sure and I know that's done. I've talked to people at investment banks where they say things like, "Oh you know, their trading desks, the biggest trade of the year is when they pay everyone."

They know that their bank is going to pay everyone their end of year bonuses. And so, they actually put in like a currency trade ahead of that. You know what I mean? Knowing that they're going to affect the Euro and things like that.

I've heard of things like that but that's usually kind of a short term things. I don't know that you can necessarily hold up a currency or keep something depressed for a long time. I think the market generally wins on that one. What do you think?

Darren: Yeah, I don't believe it. I've just listened to some podcasts from a Hedge Fund guy who he strongly believes that it's all predetermined. **He... I can't remember his name now. I will dig it up for the notes.**

He basically predicted that's over 12,000. He made all this predictions about markets and where they would go and because he has his belief that it's all predetermined where it's going to go and nobody else can interfere in it. But again, he might have just been in a rising stock market to call new highs, does not necessarily mean you can predict what's going to happen in the future.

Do you think, on this notion now of traders wanting bad news, do you think that now with arguably some sort of crazy political decision? For instance, Trump? You expect Trump to do something unusual and shake stuff up. Trader's are kind of happy when that's more the case when we've got the outcomes that everyone is expecting.

Are we generally happier with people like Trump getting in? I know this is kind of getting a bit political now. Some people will argue that Trump's going to be really good for the economy but there's a general feeling out there that he's going to do something different, shall we say.

Walter: Yeah. That in itself, when you look back at 2016 on the election day, that was really interesting to me because I think the general expectation was not only that Clinton would win but that the market had priced that in.

What was interesting if you look back at those charts, as you see the market did at 180. There were two things that came up. One was, it was a surprise result to some. The other thing was that it was like people were like, "Hang on. He's a Republican. He's a Conservative. Maybe this isn't going to be so bad for big business".

And then, the stocks are kind of exhale and said, "Oh, it's will be alright." You know what I mean? And it turn around so it was like there were two things going on there. If I put on my funny mentals hat, the first thing was surprise and the markets don't like to be surprised. They don't like uncertainty and they don't like to be surprised.

If I have to hang my hat on a couple of things, I would say you can look at the markets in a general point of view like this is really simplified. There are those times when the market is feeling like it kind of knows what's going to happen.

Like, it has a pretty good idea. And then on those times, people are pretty okay with taking on risks. There's kind of like the pro-risk market which is when everyone was like, "Yeah, we have a pretty good idea what's going on here."

And then there's the fearful market which is like, "Holy crap. I can't believe that happened, Who knows what's going to happen next and I'm so scared." That's kind of fear and a greed.

I think I would argue that that's what is really going to drive the big… So when you have things like the GFC or Francogeddon, you get this surprise results. Surprise things come in and everyone just freaks out. They just go crazy and that leads to the cascading, you know, it's fear really. It's fear of the unknown. We don't know what's going to happen.

Darren: And which of those is… Which one is the market to trade? Which is the one that we want?

Walter: Well, obviously the fastest way to make money in the market is to ride the collapse of a trend, like the end of the trend. So the market's been going up for three months, four months, six months, six years, whatever and then the uptrend is over and it collapses.

You can go back and look in August 2007. You can look on August 2008 and you can see that in September 2008, you can see this right on the charts. These big huge candles pop-up and specially on volatile pairs like the GBP/JPY.

You'll see those pop-up then and so, yes. If you had to say, how am I going to make a lot of money quickly? It would be, the end of the trend. People are freaking out and they're just like, it's complete cascade, right?

Darren: Yeah. You need a shock to trigger that. It doesn't just kind of come to an end. It comes to the end from a fundamental shift something. Something has to trigger that, isn't it?

Walter: Yeah. But, isn't it interesting? I know you're a big fan of Taleb, Nassim Taleb. Isn't it interesting though because there's this debate in Psychology about emotions -- and I'm going to link this up to Taleb in just a moment. This idea in Psychology, is it the chicken or is it the egg?

When we feel emotion, is it because we feel our body tensing up or doing whatever it does and then we say, "Oh, I must be anxious right now." Or, is it that you get anxious and then your body start to tense up?

It's the same thing I guess, when you think of what Taleb talks about with the Black Swan, which is we have these things happen in the markets and in fact throughout history and then later on we kind of overlay it and kind of massage it and make it look

like, “Oh yeah, that’s why this happened. That’s why Hitler was able to secure power.” “That’s why we had the GFC.” It’s kind of this hindsight bias where we massage it and make it all fit into the box after the fact.

Darren: Yeah. This idea that any reason is a good reason. Have you heard of that saying before?

Walter: Yes. I know you’re a big fan -- as I am of Taleb and this idea that... I remember explaining this to a group of traders. We were like in a... This was the trading tribe that I used to go to which is Ed Sekoyta’s group and he has this around the world.

We were talking and I was talking about... It was when I had first read the Black Swan and I was explaining the basic idea which is these things happen. These shocks happen and then we go back and explain them and make them fit.

It was never that Hitler seized power. It was this Hitler had this slow build of power, you know what I mean? Like, these things are never just all the sudden, out of somewhere, something happens. It wasn’t that the GFC, when you wake up one day there’s a GFC. No, it was a slow accumulation of junk debt that led to the GFC and things like that.

Darren: Yeah. We’re obsessed with this cause and effect thing, aren’t we? That in every outcome, it has a real obvious reason. What I see in this, specially in trading, there’s like so many little elements of luck that come into that as well.

You’re talking about Hitler. To get where he was, there was a lot of luck along the way there for him anyway. He should have been kick out the party and elements of luck kept him in there.

I think that’s what I see all the time in people’s trading. They try to explain every kind of movement in a chart and why they hit their profit and why an entry stopped out. I stopped thinking that way long time ago.

Walter: Yeah, right. At the end of the day, you can do whatever you want and you can plan for everything and the market’s going to go where it’s going to go. You could miss your target by one pip and then reverse five hundred pips after that.

That can happen and that’s the great thing about trading though. The uncertainty. You have to just embrace the uncertainty and go, “You know what? This is what we get paid to do.”

We get paid to look at this and just say, “Yeah, I don’t know what’s going to happen but here’s my risk capital and take it. Do with it what you want market and we’ll see where we’ll end up.”

Darren: Yeah. I think those people who never really embrace it are the other ones who never get that really. As long as you try and look for reasons for every little outcome in all of your trades, I think you stomp.

Walter: Yeah, they want to control it. Do you think that most traders probably are like Alessio Rastani and they dream of the next GFC? Do you think most of the traders think that way?

Darren: I don't think they do. I think maybe the small percentage of winners do. I think most traders are not thinking that way. They want to think that everything because you can determine every movement that's going to come. You can plan in out and you can get your expected returns and nothing unusual is going to happen.

The only other outcome you're going to get is the one that you're expected to get. Even if you're not at that point yet, at some point you will get there and that means that you're a good trader. I think the majority of people think like that.

Walter: Yeah, it's interesting.

Darren: I am always hoping for a house in price crash. I'm always hoping for that just to prove that I was right, as much as anything.

Walter: Yeah. I mean, it's one of those things. Like, the market can prove you long, just long enough to milk, to drain all your account to get all of your money and then allow you to turn and then allow you to be right, those sorts of things.

You hear those stories of Burry in the "Big Short" where he is stretched to his limit. I remember when I first started trading, there was a lot of those trades where it just felt like at that very point where I just had to throw in the towel, I couldn't take the pain anymore of the losing trade.

I already removed my stop and kept moving my stop and kept moving my stop. Luckily, I wasn't big in to averaging down like for people who would add to a losing trade. I don't know why. I didn't really get into that.

I did a little bit in very early part but what I would typically do, my big mistake was to keep moving my stop. What that did is it kept increasing the loss. Eventually, I would just finally say, "Oh I can't take it anymore and take the loss".

It was amazing how often that was actually the end of the move. As soon as I threw in the towel, that was the turning point and that's crazy.

Darren: I think that's where you... The way you need to live as a successful trader. You need to live right on the extremes there. As soon as you try to find a sort of comfortable middle ground, that's the place where there's no profit or edge to be had.

Whether it's continuing to take entries when you've had a string of losers or having a string of losers and then holding on to your winner until it reaches your target. It's kind of those extremes.

It is those shock. If you think really every trade you should be looking for that shock event where whether that be having continual winners with a really small target or holding trades for very big winners.

It's those extremes is where the success is in trading. In a way, going back to the original point, you're right. You have to be hoping for the next big shock event because I think that's where the money is to be made.

Walter: Yeah. What's interesting to me is I have a lot of friends who are older retired gentlemen who aren't traders, they're investors and they don't. They are fearful. They just want to ride the blue chips stocks out and they want to see the markets go up. That's what they want. They just want the status quo.

As a trader, I'm always trying to remind them that that's not the way that the markets always run. At the very least, you should have some downside insurance like in a form of options or whatever and a lot of times these guys and I've learned a lot from these guys. I'm not disputing that.

These are like mentors to me. These older gentlemen who are retired and have lots of life experience but I think that's interesting to me that they don't see it that way. They don't --- I think they underestimate the risk. Their capital is at when they're just simply long shares.

It's crazy to me. It's like somebody who is a property investor and they just invest in one city. It's just like being long one company. I'm just going to buy Apple and everytime I'll get money. I'm just going to put more money into Apple.

That's crazy to me but people do that and they consider it normal and they consider it, it's what you should do. Take all of your retirement money and sink them into property investments or whatever.

It's just crazy to me but I would never do that as a trader. I look for ways to diversify risk. It's just fascinating to me that the share investors are kind of on the opposite side of the spectrum.

I suppose they want low volatility and they just want the markets to just keep steadily marching up, upward really I suppose. They don't really want any shocks to the system and they diversify.

To me, they diversify and I'm not really being general here but I think your standard share investor doesn't really do much in terms of diversification. They think that if they buy Tesla's stock and General Electric stock and Bank of America, they're diversified. You know what I mean?

Darren: Yeah. I've been looking at this in Forex trading recently. I've been looking at how to diversify. Diversification with different strategies and different currencies, it never works for me looking at different pairs.

I find this just like a curve fitting things. You flick through until you find the chart that would have given you a good winning run. You instantly think, "Well, the answer is just to keep adding instruments." Your band hit the winning ones sooner or later but it doesn't work, does it?

Walter: No. That's right, it doesn't. Again, we're fighting our instincts, aren't we? To get at the very point that you give up is really the turning point of the market and these sorts of things seem to creep up for traders.

Well, Darren, I guess I would say that the speculator is looking for the next big, the big bad news to come out. Unfortunately, I think that's where we're at. I don't think it's necessarily immoral though.

I think that's overplayed. You think about businesses or industries that collapsed. For example, railroads used to be the big industry and then they sort of collapsed and gave way to the automobile.

Well, there'll be something else that comes around after the automobile and the automobile industry will disintegrate. And so, it's just kind of there's innovation, right? You have new industries that are born and grow from the ashes of the stuff that's been totally obliterated.

I don't look at it that way. I think it's more of a cycle of rebirth really than just, "Oh you know, we're all happy that Union Railroad is no longer in the dollar or whatever. They've gone bankrupt." It's not really that way.

Darren: Yeah. And I don't think it's down to us as traders to make the world a moral or immoral place. We don't really have that control, do we?

Walter: Yeah, that's right. Exactly. We don't make... For example, maybe thinking that the JPY is going to depreciate, you don't make it depreciate. You just look at your chart. You look at your trading system.

You say, "Well, it's telling me the Yen's going to depreciate." You know you're not happy that the people in Japan are losing their buying power. That never comes in mind. I never think about that.

It just doesn't... It's just weird that people would say that. I think, it's an easy out for people who want to demonize trading or capitalism in general. They'll just say, "You're a dirty trader. You're capitalizing on other people's suffering." Well, I don't know about that. I don't think that's what's going on here.

Darren: Yeah.

Walter: Anyway, it was great to talk to you, Darren and we will see you on the next episode. Thanks for your time.

Darren: Okay, Walter. Thanks.