

2 TRADERS

EP02: Fear and Self-Awareness

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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: Okay, welcome back. It's Walter here, from The Two Traders Podcast. The other trader, of course, is Darren. Darren, how are you?

Darren: I'm very good Walter. Nice to see you again.

Walter: Yeah so Darren, we've talked a little bit about - offline without the recording going - we've talked a little bit about fear in the past, and we thought that it would be a good idea to tackle that into today's episode.

Now, of course, traders are all aware of the fear and greed sort of thing. You hear that a lot. Trading is all about fear and greed. Markets are driven by fear and greed, herd mentality and stuff like that. But, you were talking about a university lecturer who was going in to examine risk. Can you tell us that story, because I found that fascinating.

Darren: Yeah, this professor Mark Fenton and basically he was going into the banks in London to speak to traders about risk, and one of his research colleagues came to him and said this is amazing. All of these traders are talking to us about their emotions and their feelings and so basically he started to look into it a bit more and he found that there was distinct differences between the high achievers and the low achievers when it came to how they dealt with their feelings.

So basically, he was speaking to the best traders and he found that they could speak really plainly and clearly about their feelings. They were much more articulate about their feelings and they weren't afraid to use them or discuss

them, whereas the under performing traders were much more dismissive and they were oh I haven't got a problem with my emotions. I just push them to one side and they were either ignoring or suppressing their feelings. So, this - we speak a lot about decision making and feelings and this supports that.

Walter: I think is fascinating because a lot of times - well, just today I was talking to a trader and we were talking about this idea of when you first start trading you look at trading and you think well, we're just going to follow this system. All I need is a really good system to follow it and then the money will follow.

But in the end what ends up happening with most traders, if they stick with it long enough, is they realize that your trading is actually like self reflection. You get this feedback from your actions, from the market, and it really challenges you to closely examine how you react. The emotions that boil up and the way approach things because if you don't do that, if you don't take those lessons that the market teaches you then you're probably going to end up in a bit of trouble. Would you say?

Darren: Yeah, definitely. I mean, one of his key findings was that the high achievers were really aware of how important the feelings were, and then they knew to - when they had that feeling - they knew not to just act on it straight away.

So, I mean, they talked about their intuition as well and the novice traders were talking about it like it's a sixth sense and like it's a bit of something mystical, whereas the high achievers knew that they were going to get these gut feelings but they didn't rely on them. They always looked for something else to back it up and I think that's the key element in all of this is we're all going to have these feelings. Especially fear being the most common one, but it's knowing to correlate that with some other information before you decide to act.

Walter: Right, so the critical piece here is, I guess, one you've got to be aware of what's going on and two, you've got to have some sort of coping mechanism or some sort of plan for dealing with that. Because, a lot of traders until the actual moment comes up, until you're in a massive draw down, if you haven't really planned for that - and it's not really the mechanics of dealing with your account so much as how to deal with your emotions and what you go through - unless you have a good way to navigate those choppy waters, there's a couple of things that can happen.

I mean, and this happens quite a bit. It can end up ending your trading career, it's even ended trader's lives by having a - such a terrible string of emotions that they feel like this is it for them. So, it's something that's very confronting and I

suppose - it sounds like from what you learned, that they were able to zero in on this fact that one critical aspect of distinguishing a trader who is more, shall we say, highly evolved or more experienced is that he is likely to have a plan in terms of dealing with his emotions.

He is aware of them, and he knows that there's a way for him to deal with these emotions. Whereas those traders who just say no I've got it. It's under control. I understand this. I do well. Psychology isn't a problem for me. Oh no, it's just following my system. Those people who are more dismissive of the emotions that come up are more likely to be either earlier on in their trading career or they're someone who just isn't quite there yet. They're not at the point where they're consistently making money.

Darren: Yeah, I completely agree Walter. With the idea of planning we always talk about - I think we've spoken about it before - we always talk about planning the actually the actual technical elements of our trading. But, there's never any mention of planning what you're going to do when it comes to your exit and your racked with fear. How you're going to deal with that emotion, how you're going to regulate that emotion, how you're going to deal with a losing day.

Because you must know your strategy is not going to win every day, no matter how good it is. So, where's the plan for how are you going to deal with those emotions at the end of the day, and people generally don't give that any thought and there's very little written about it. I know now it's becoming - it's coming more to the front in the trading world, especially the retail trading world and there are some simple things you can do to improve. I mean, he found that this is something that you do learn over time. The higher achievers have been trading for a longer time and his was such ... I think he said about ten to 15 years to get good at it. But, is that ten to 15 years because at the start all they were looking at was the charts and the technical aspect of it?

Can we jump the queue? Can we get an edge by learning to be more self aware and using our emotions to our advantage or being able to decide which emotions are good and what we should use and which ones are bad.

Walter: Right, so do you subscribe to the idea that there are good and bad emotions in trading or is that just a label, or how do - how would you ... For you, personally, how would you characterize emotions?

Darren: It depends if there's a reason for it. That's a - in layman's terms, is there a reason that you're feeling fear? Say you take an entry and price goes 50 pips in your direction, and then it retraces nearly all the way back to your entry point.

At that point, you get a surge of emotions and you're - you have the fear, because you had a winning trade and now it's going to look like it's going to be a losing trade. But, if in your plan this is a natural movement from the market and this is what's expected to happen, then you shouldn't doubt that emotion.

So, that is - that can be a bad emotion if you act it out. So, at that point you have to back your feeling up with the data you've got and then act accordingly. That's how I see it, anyway.

Walter: Sure, yeah, yeah, and so one of the interesting things I find in the whole self improvement or whatever you want to call it. Personal psychology or something like that. Self help I guess they would say in the US so - is this idea of making an effort to journal or to write down your thoughts, and making an effort to just write something.

And, you might not think that you have anything to say or there's anything that's going to come of it. But, typically what happens when people do this is they find that it organizes their thoughts and their feelings. So, they've had these in underneath the surface and they feel them, and they're there and they're real but once you start writing about them it's almost as if you're an observer right? And, if we know anything about performance psychology we know that one way that you can certainly become better at anything - anything improve your performance is to take a step outside of yourself and imagine that you're watching yourself doing that thing.

Whatever that thing is. If it's trading or if it's gymnastics or race car driving or whatever. Whatever you're doing. So, I often wonder if that's - it's sort of the same mechanism with journaling or with keeping track of your thoughts and feelings is, if that's what's going on, is that you're taking the role of outside observer and that's where the value is coming. That's where the changes are coming from because you're taking it from a different perspective and it may allow you - if you think logically - it may allow you to logically come to a plan, or ... Even if you're not necessarily a very logical person, you're more of a go by my gut, even that may be helped by organizing your thoughts and writing them down.

Because it's like those things that were there and that you felt are now actually concrete and in front of you, and they're easier to manipulate I guess is one way to look at it. Have - is that something that you've come across?

Darren: Yes, actually one of the main findings was of the things that could help traders make better decisions whilst writing things down, and they found that it made you accountable for your actions then. Because, you'd written down in paper what you were going to do and then if you went off plan then you - traders found it much harder to go off plan because they'd written it down, and they also found that the best traders had a rule that if they were going to change anything about their approach or their technical strategy that they had to write it down first, and they said that after a really bad day when the emotions are high and you're feeling bad sitting there writing it down. But, usually by the time they'd written it down they'd realized that it was just an emotional response rather than a logical response based on the strategy failing.

There was two things that they banked really important. One was writing things down, and the other one was emotional support. They found that the traders who had really good man managers that gave them lots of support when they were having a - they were in a hole and they needed to dig themselves out, those traders performed much better. I don't know where we get that support. I guess that's why we want to be in trading groups and Skype groups that we can share that support. The problem is with that, though, is people being novices tend to talk down the emotional side of it and just talk about the strategy.

Oh, I should've added this moving average or the RSI instead of saying well look, the strategy actually performed well today and I made some emotional decisions which cost me my profit.

Walter: That's right. That's exactly it isn't it? It's - it all comes back to you.

Darren: Exactly.

Walter: I laugh when I - yeah, I mean that's it. I laugh when I hear people say things like oh, so you're a psychologist but you're not doing anything with that. Why aren't you doing anything with that? And, I think that's a funny way to look at trading to me. Because to me it is so much psychology and so much self reflection. I think that that's interesting that they suggested or that they thought that the journaling aspect was something that was to be used as a tool.

I wonder though, Darren, if in your experience have you found that there's this idea of hindsight bias right? So, is there any way that that can creep in and color our views of what's happened?

So let's say that we are going to take this seriously. Okay, and we're going to write down our thoughts and our emotions at the end of the trading day or even just at the end of a trade. So, my concern would be that there's the potential for us to say something like oh well, I should've known that that was going to happen because it did this and so we color the past with the knowledge of the future right? Which is, essentially, what the hindsight bias is and our history textbooks are full of this sort of thing.

And, those listeners who are familiar with The Black Swan and that idea of ... It's a similar idea I suppose. Where we have these events and then we go back and explain them away based on what we know today. We explain the past. But, my question I guess, Darren, is there a concern for you?

Darren: Yeah, I don't know what we ... I don't know what you do about it.

Walter: Yeah.

Darren: I mean, I suppose at some point if you're going to make it as a trader your desire to be a trader has got to kick in and say - and realize that you're doing this and say okay, now is the time to start being accountable for my actions or I might as well just give up.

And, you see it all the time. People strive for years to try and make progress as a trader and they eventually give up or sometimes it's their final throw of the dice and they throw out everything that they've been doing before and realize that the real problem is within themselves, and maybe they're the ones who finally make it. I mean, I used to think the 95 percent fail idea was made up but when you understand the psychology required to succeed at it then you can understand that a lot of people would fail at trading. It's really hard especially - it's not as if we're walking into a classroom and there's someone from day one who says right. This is really important to you. I mean, from day one you go to any site and you're instantly hit with technical analysis and when you realize that that's such a small part of the big picture, then you realize why people do find it so hard.

One other thing, I wanted to mention that he found that the high achievers did, they had this ability to - what he called re-framing the feelings. So, when the high achieving traders took a loss they still were feeling that pain. That horrible pain you get whenever you take a loser, but then they were able to take that feeling and put it into context in the bigger picture. Okay well, my win rate is only 50

percent anyway so it's going to happen. Onwards and upwards, and they continue on. Rather than their next action being affected by that.

So yeah, it's a really interesting paper.

Walter: Right, so it sounds like the - it sounds like, if I'm getting this correct, it sounds like that the high achievers were able to view the trades as independent essentially, right?

It doesn't matter that my last trade was a loser, that my last three were a loser. The next one is here. It's in front of me, and I'm going to take it. Is that fair to say?

Darren: Yeah, definitely. They could see them in context of a bigger picture rather than a single trade being important.

Walter: Yeah, interesting. I think one of the things that comes up for me, Darren, is this idea that you're - like you say, when you get into trading you're hit by technical analysis. You're hit by systems. You focus on the systems and you believe that that is all you need. Now, I guess it brings up this idea of we spend so much time fine tuning and honing our systems as traders.

I'm not saying that everyone does, I'm saying that certainly it's a part of it, even if it's just the beginning. Even if it's only the first couple of years as a trader where you spend time doing this. Maybe not so much later on, but I believe for a lot of traders it's the reason why they never get good is because they're always spending so much time on the system. It's all about the system and fine tuning the system. But I wonder, and maybe this is probably left for another episode, but one of the things I'd like to talk about is this idea that it's the edge. Is the edge really the system or, again, this is probably another episode but - and we will have to talk about this in the future.

Is the reason why you make money as a trader, consistently pull in profits from the market, is that because of what you - the work you are doing on you, with you, or is it because of all of the time and effort that you've done with your system. So, that's - to me that's the kernel in the issue is where are you going to make your largest gain? Is it working on you or is it by fine tuning what you do in the market? Your entries and exits, and money management and so forth?

Darren: Yeah, well that's going to be a whole other episode Walter, and yeah maybe we should do that one next.

Walter: Yeah. Yeah, that sounds good. I guess the reason why I ask that is because a lot of traders - as I see it - in the beginning that's - the focus is on the system and fair enough. Fair enough. Certainly if I just stick with my system so and so he's written a book and he's doing this and it seems to work for him, or so and so on this forum in the trade he's making money. Look at this, this awesome oscillator is perfect. It's the greatest system ever. I'll just do what he does and they don't realize that so much of it is really about you. Isn't it?

Darren: Mark Fenton made a really good analogy and he was saying, when you first learned to drive a car, your mind is all about the gear stick and the clutch, and steering and combining all of them together and you're having to use all of your brain power to do those. And then, after a while all of those just happen automatically without you giving any thought to it at all, and then the only time you put all of your focus on driving is when a - say a danger - say you saw a small child stepping out into the road then all of a sudden all your focus goes, gets focused directly on what you're doing and how you're going to avoid the situation, and that is what happens in trading. You start off and you learn about the strategy, and then after a while you should be doing that automatically.

And then, your important decisions are at those key moments in trading like when you need to take profit, when you need to pull the trigger if something unusual happens and then you need to focus all of your abilities on the chart and then make the right decision and that's what really gives you the edge. Is that ability, in those key moments to make the right decision and the actual how you drive, everyone drives slightly differently but you're getting from A to B, basically.

So, there's a lot of technical strategies but if you're not making right decisions at key moments then you're going to struggle. That's how I see it anyway.

Walter: Yeah, Yeah, absolutely and I think that's well said. I mean, as traders we - it's one of things that, it's almost like you feel like you have to say to someone who's starting out you just have to see for yourself. You just have to see for yourself how it all falls into place. It's just sort of a natural-

Darren: Yeah.

Walter: -progression.

Darren: Did you - I don't know which market wizard's book it's in, but in there he does an interview with a trader that remains nameless and he's asking him about how he

trades, and he literally gets up in the morning, goes to the charts, and these are his words as much as I can remember. And basically, he said well, if price looks like it's going down then I just sell and if it continues to go down for a bit then I'll take profit and if it comes back and goes the other way I'll close my sell and buy, and when he says that it sounds like madness. But, when you break it down and think about it that is essentially what we all should be doing really, and the technical strategy that we use is just some sort of structure to build your working day around.

I thought, this guy must be really in tune with his emotions and I imagine that's come from years and years of experience. That's not something you're just born with. That is years of experience, but it's just not - it's not just years of experience with staring at the charts. That has obviously helped him, being able to get a feeling when the market doesn't want to drop anymore and when he should exit, But, at some point he's become really self aware of how important his decisions are and how that he's going to be feeling fear when he enters the market seemingly randomly but at the end of the day it doesn't really make a difference on his bottom line, and that was a really good section out of the book for me.

Because we don't want to - we have this fear of failure what we do is we kind of I don't really have a problem with my emotions. Because they don't really want to confront the fact that they need to change their emotions. Perhaps - when you talk about psychology it seems like something intangible that you can't really measure or work out and so it probably appears to be something really difficult. But, you find when you start doing just small exercises like we were saying about writing things down or perhaps discussing your emotions with trader friends. About your emotions throughout the day or when you were exiting and entering. Those little things, and suddenly the lights start coming on and you realize. You get a bit of confidence in your ability to change then.

I know when I quit - I was a heavy smoker for years, and I convinced myself that I couldn't give up so I really never tried and then when the moment came that I had to give up smoking I did it really easily, and I was expecting ... You hear all these stories about massive physical withdrawal and that you'll be climbing the walls. I didn't have any of that. Once I'd decided in my mind that I was going to - I'd had it with smoking, within a week I never got a craving again. I just stopped. So, I think it's the same with trading. You just need to make that first step of including it in your trading. Just put a - so whenever you talk about a technical element talk about the emotions and the feelings of operating that element as

well, and I think you can achieve a lot in a short period of time and maybe you'll never become a zen master but you really don't need to be.

Denise Shaw says that if most traders can remove 25 percent of their errors from their trading they'd be profitable. So, that's a good target to aim for first. Stage one, clear documented strategies and then write things down before you make any changes. That's, if this is something you're having trouble with, that's stage one. Yeah, write things down and clearly document your strategy. Every says they've done. I imagine most people haven't.

Walter: Yeah that's it. Yeah, and I would just add to that that perhaps you want to make sure that you that you're able to track not only your trades but your emotions. Make sure that you have that right as a record. You can go back and look at that.

One thing that makes sense for some people is to actually record your voice. So, as you are taking your trade you record your voice, and you talk about the trade and why you like it and what you're concerned about and some possible scenarios, and then again you record if you're managing the trade, moving to break even, taking profit or whatever and then recording again when the trade is finally closed out.

So, it's an audio journal and sometimes you'll get more emotion in that than you would in just the written word, so that's another possible thing to do. And another thing that just popped into my head, and we'll probably have to tackle this in another episode all together on it's own - is finding some sort of way to - some sort of support system for you as a trader. Now, there are many different ways to do this but one of the ones that I think we'll definitely have to jump into this in another episode is the idea of trading tribe and I'll get into the trading tribe later. Some of you are probably members and some of you know what I'm talking about but for others this is going to be a new concept. But, this is just a ... Essentially it's a trading group that anyone can join and it's very useful because it's all about emotions and I think that would probably make a good episode in and of itself.

Well, this has been interesting Darren. I really thank you for your time and I look forward to seeing you next time.

Darren: Yeah, thank you Walter and I'll see you next time.