EP71: Confidence and Fears

Walter: Why is it that I feel so much pain when I am trading? Is it because of something in my history related to this desire to win?

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. Walter here and Darren, we are going to talk about one of the listener's question today. Specifically, the question is: I have lack of confidence in the analysis and therefore having to get out of the trade very soon with little profit out of fear of it failing.

What can you say to this, Darren?

Darren: The word that jumps out of me is the "analysis". What I think the issue here is the trader is associating the problem with the element that probably is not the problem and missing the real call of the issue.

If you have lack of confidence in your analysis and you need to question, have you back tested the process that you are using, the strategy you are using? You should have if you are trading it and you should have a clear idea of how it is likely to perform over a period of trades.

The real issue here is that we, all of us as traders, fail to accept that trading is generally about feeling bad and reveal winning or losing whether you are following your process or not.

There's always going to be an element of pain associated with trading. It is an uncomfortable environment to be in. That lack of confidence feeling is generally always there.

Now, if you know that that's not ought to feel that way then, you can focus on dealing with the problem which is basically your feelings when you are trading. If you associate that with a particular part of your strategy such as your type of analysis, then you're never going to find the process of dealing with that and you are always going to be making mistakes.

I heard a great quote the other day which is simply "trading is pain" and it is. You'll always going to feel bad, you'll always going to feel that you should've stayed in your trade longer, you'll always going to feel like you shouldn't have taken that trade because it was a loser.

The important thing to know is that is a natural feeling and you need to work on the processes to deal with that rather than associating it with a particular technical part of your strategy.

Walter: Right. Basically, what you are saying is the way to adapt the healthy outlook is to change your perspective here. Is that right?

Darren: Yes because, let's be honest, this trader must be using some sort of systematic analysis to decide when to trade and when to get out of his trade. If he has decided that that is the way that he is going to trade then he must have done some testing on it and it must have a positive outcome.

Otherwise, you'd look for something else, you wouldn't just continue with it. If you know it's got a positive expectancy and then when you are trading and you've got a lack of confidence, it is not the analysis that is the problem.

It is the fact that in the moment, you are struggling to deal with the emotions of actually trading.

Walter: Yup, exactly. What I and most traders I suppose have probably realized is there's several ways of feeling the pain, as you, say in trading. The first would be that there was an excellent trading opportunity and you missed it for whatever reason.

That is usually the one that a lot of traders think "Oh, that's terrible. That is really one tough to deal with". The other one would be that you took a trade and it ended up being a loser. Sometimes what will happen when it's a loser is you can go back and go "I should've known here. I should've gone out earlier before I got lost this much" or whatever.

Or, "there's a little bit of profit available to me. I should've taken it instead of letting it turn into a loser". Those things starts to creep up too. Finally, the situation where you have a trade that almost turns out to be a winner but snatches defeat from the jaws of victory and becomes a horrible loser.

Those are the three types. There's the really good trade that turns bad, there's the really bad that might have been good, and then there's the excellent trade that was no trade at all. To me, those are the things that traders roll around over and over again, those sorts of situations.

The easy way, I believe, to change or adapt a different point of view is to reframe it. Reframe this in a way so that you are not really looking at the outcome. You should be concentrating on your execution, on what you are doing in terms of the parameters of what your system sets out to do.

For example, if I have a trade that goes all the way -- and this happens to me as with many other traders -- go all the way really, really close to where I want to get out and takes some profit but then turns around and comes back, what that usually mean is it will hit a break even stop because my stop has been moved to breakeven once it gets close to that target.

A lot of traders would look for reasons to change the system or adapt, add rules so that if it goes really close to your target, you can take profit early but I know that is not really going to help me because that is just going to reduce my average winner.

That is not going to help my trading system, it is going to change it into something different than what I tested. What that means is I try to reframe that breakeven results. Instead of calling this a trade that is a winner turn into a breakeven, I call it the trade that never happened.

Any trade that I have, for me that is a breakeven trade. I just consider it it's wiped off the books. It could be a small win or a small loss, obviously depending on exactly where you place your stop and the swap on the pair you are paying if you get a little bit.

To me, that is one of the solutions here for people that are listening to this is to reframe, to look at a different point of view. I agree with you in that respect, Darren. I also think that sometimes we get caught up in the result and we should really be focusing on something different which is the execution.

I think the very first traders that I've come across, they are focused on execution. They do not adapt and change and twist things around and add rules and caveat and if then sort of situation, they stumped on the result of the trade. Instead, they are focused on the actual execution.

What do you think about that? In terms of execution, is that something that you can say "Yeah, that makes sense in terms of how do I eliminate this lack of confidence" because, basically, what this trader is saying "my lack of confidence in the analysis and getting out of the trade very soon with little profit because I have fear it's failing".

Basically, what they are saying is they are holding themselves accountable for the results of the trade. They are saying "Whatever I am doing here is the reason why this trade ends up the way it does".

What I'm saying is let's shift that focus away from "if you make money out of the trade, you did good and if you don't make money on the trade then you did bad." Let us not talk about that because, really, what you should be doing is looking at am I

executing the system? Am I sticking to the rules that I should? Am I working within the parameters of that box that I'd set up for myself? And if so, then that is good regardless of result.

Darren: Yeah. You need to judge the trade on how you act it. Did you follow your plan? Did you do what you meant to do? Did you change at the last moment for some reason that was not part of your process?

There's a notion as well that we can get to a point where good analysis will eradicate all of those unpleasant sights to trading. If your trading still has unpleasant elements to it then, somehow, that that can be resolved just by better analysis.

Any sort of you've taken the time to study results over the long period of time, you will realize that it's something that's not really attainable. For sure, some people may get to that element but, generally, most successful traders are working a risk model over a long period of time.

Also, when you have good analysis and you work out that it is your edge in the market, real edges are much finer than we expect they are going to be. We expect them when we do have an edge that it's going to be much more clear cut, we are going to win much more than we ever do.

We are going to have less drawdowns and it's going to be much smoother as well. We're going to expect it to be very smooth, generally winning all the time and when we have losses, that will always be small and it does not pan out like that.

You have periods of performing really well, you have periods where it's really difficult and you have to look at the bigger picture. Trying to eradicate those unpleasant feelings by analysis alone is a much harder route to go down than accepting that.

Even if you are trading well, even if you've got good analysis, there is going to be elements in that that feel unpleasant still and you better just accept that than trying and removing completely from your game.

Walter: So what do you do? As a trader, how do you grow to accept that? I imagine that a lot of people who get into trading -- I could be wrong -- but a lot of people who get into trading, they probably feel some sort of success than other domain in life.

They are trying to make this trading work and they are trying to get to the point where they feel like they're pretty confident that they can go in and they can make money out of the markets.

Now, trading is very different and I've heard some of the best quotes about trading. I've heard this idea that trading is about losing. Trading is about learning how to lose. Trading is about really looking at the bigger picture.

In terms of instead of looking at the last trade, which a lot of traders do and adapting a different strategy and watching that morph based on your last trade or last couple of trades, try and look at chunks of trades.

Try and look at the next hundred trades then take a step back and analyze. Don't spend time analyzing the last one or two or three trade, that is not going to be very productive.

A lot of people who get into trading, they are successful. They found success in other things, other areas of their life and then trying to make this work. It's really pouring to them because as you say, Darren, you can look back at the chart and hindsight bias creeps up, optimism bias creeps up.

All of these cognitive biases creeps up and whispering in your ear "Oh, you would've done really well here" or "You would've taken that one", "Oh you would've done that" and you'll see all these brilliant situations to make money in the markets.

You forget, or skim over, don't even see, ignore those ones were you would've lost. I believe trading is really about learning how to lose. It is about learning to let go of the individual result for each individual trade and instead, you need to enable yourself to see it in from a very different point of view.

See it well from how well you are executing and how are your trades are doing in terms of the chunks of the trade, not the individual trade.

Darren: Definitely. And we want that short term fix, don't we? We want to win at every trade, we want to be winning at the end of the day, at the end of the week, and it just doesn't come quite as smoothly as that.

We are quite fortunate nowadays because there's so much out there from traders that have had long successful careers. The information is everywhere in books and on the internet.

If you look at the traders that have got a sustained success in the market and a great track record, they will all tell you the same. Pretty much the same thing from completely different perspective, from different trading styles and different strategies, they will all be telling you essentially the same thing which is about the long run and accepting the losses.

Obviously, there's a lot of bad informations out there, as well. Sort of Instagram traders with their pictures of Ferraris and "I made all this money last week" as well.

If you are serious about trading, go and look up the traders with the good track records and have a listen to what they have to say and then make that part of your game. Then, perhaps, go back to your strategy and look at it from a different perspective.

Walter: I would look at the other side of the coin which is the traders who wants to win and see what happens to them. You can look up at different traders who have reportedly gone bust.

Now, I can't verify if they have or not but, for example --and I will put this on the **shownotes for this episode** -- you can look up at Victor Niederhoffer who wrote the book The Education of a Speculator.

Apparently, reportedly Victor Niederhoffer had a student who is Nassim Nicholas Taleb who wrote the "Black Swan" and "Antifragile" and all that. I know you are a big Taleb fan. Right, Darren?

Darren: Yeah, I really like his stuff.

Walter: Yeah. And he consults with funds and teaches them how to deal with, essentially, with black swans in the market and how to insure against that. How to insure their fund against those situations.

What's interesting is, if you look onto the internet, this is what you'll find. You'll find that a lot of people want to win. So you are going to find, especially when you get into these free forums, you see any number of people toying around the idea of Martingale Method and so that's always going to come up.

The Martingale Method is, essentially... It's basically the will to win and translated into an equity curve. It's basically what's is. This desire to win all the time is basically where the Martingale came from.

You'll see, if you'll look at it, you'll see that the Martingale equity curve is pretty bad. What happens, typically, is it's a straight line, 45 degree angle up, up, up and then boom, it just falls off a cliff.

We've talked about this and it's basically gets margin called or whatever and the account is toast. There was a guy, I won't really name names or anything but, there was a guy that I heard about and he had sold a lot of robots.

This was back in the heyday of the forex trading robots and he knew somebody that I knew, this guy sells his robot. He is basically selling people the idea that they don't have to lose in forex trade.

You buy this robot and you are always going to win, that was the idea. That is why he sold a whole bunch of robots and made a whole bunch of money. He told me, he said that robots are a load of crap. He said that to me.

His whole empire was based on selling people crap robot, by his own words. "Robots are crap, they don't work". That's what he did, he sold this idea that you can make money by winning all the time.

Victor Niederhoffer who has had a student Nassim Taleb. **Victor Niederhoffer** who basically started funds and apparently, reportedly blew up a few funds which just basically made money everyday.

A little bit of money every single day and then one day it went boom! It went bust when the market get a little bit out of control, a little bit volatile, that is when he'd go bust. He was basically writing options for things he didn't know.

So when the markets finally got to the point where he had to pay up, he couldn't because he did not known it. That was basically what happened to him at least two times. Some people report three and Nassim Taleb has taken on the other side of that.

Nassim Taleb has taken on the other side where he just wants to lose money everyday, everyday, everyday then one day boom! He got, hits the jackpot. He did the exact opposite of his mentor.

The reason why I am mentioning this thing is we have the strong desire to win and, in trading, it's no different. That may serve you well in other areas of life, like if you are a business owner or whatever and you want to crush the competition or whatever.

These sort of things, maybe that works there, but when it comes to trading, you've got to learn how to lose like Nassim Taleb. If you try and pondered to that feeling of really wanting to win all the time like the Martingale traders or Victor Niederhoffer, you probably are going to the point where you are going to go bust.

It is up to you, I mean you can decide. You can feel good a lot of the time then one day go bust or, you can adapt a different point of view where you are taking a longer point of view. You are looking farther out to the horizon and you are deciding that instead of trying to win, win, win all the time, you can lose a little bit.

Lose more than is comfortable and work on yourself. What does that mean to you that you feel really bad when you are losing? Is there something in your history that you can point to and say "Yeah, this is what's going on"?

This is why these feelings are babbling up from me because of, essentially, my psychology and my background. That is why it feels so painful for me to go through these losing periods. It is really an opportunity for you as a trader to get better as a person by embracing these things and looking at why it is that you always want to win and so forth.

I do believe that getting really, really good at this is learning to let go and not trying to win all the time. Letting go can be as simple as watching a trade go 90% of the way to your target and then coming back and stopping you out at breakeven.

Or, watching a trailing exit execute precisely as you set up that trailing exit so that instead of maybe you're up 600 pips on this trade and then the trailing exit finally gets clicked in and you only make 390 pips because it retraced or there's a gap over the weekend or whatever happened.

That can be letting go too and allowing yourself to just go with the system rather than trying to impose your will to win. There are a lot of deep stuffs when you get into this, Darren. This idea of learning how to lose and letting go.

The introspection involved in "why is it that I feel so much pain when I am trading"? Is it because of something in my history related to this desire to win?

Darren: Yeah. And, there a few simple things that we can incorporate in our trading strategies as well that reduce the effects of these bad emotions, the effects of making bad decisions because of emotions.

I find that a lot of traders do not define their exit clearly enough in their strategies. The reason there is it seems to be more appealing to have a completely discretionary exit because that way, it gives you an out when you have these bad feelings.

Like you say, if you can get close to your target and it does not make it there then you can basically analyze yourself out of the trade. You can say "Oh well, there's a descending trendline there so I am going to take profit early on this one".

You'll find out that we are really good at doing that. We are really good at talking at our self out of a trade and build in a story behind it so we can feel comfortable with making that decision knowing full well that we are not sticking to our plan.

Everyone should have really clearly defined exit plans and there should be a really clearly defined trigger as when you make those decisions.

You can have a selection of options that you picked to use but, again, it needs to be clearly defined and then you need to go to a process of just working that system. That in the end will give you more confidence in your system but it won't happen overnight and it's going to take a lot of practice to get to that point.

As sometimes, listening to people describing to me how they are trading and I think "Well, that is going to be an issue". It may not be watch you sat in here or when you are backtesting, but trust me when you are a 400 pips down for the week and the market is being a mere and it is going against you, you are going to come unstuck with that lack of structure to your trading.

We are always with our strategies. We are focusing on what is going to make the best money. A lot of the time, the rules we should be incorporating should be what is going to keep me out of the most trouble.

Obviously, there's should be an edge there but you can't build structure until that, as well. Where it's going to stop you from making silly mistakes and if you can reduce your human errors down to a small a number as possible, that would make more of a difference on the bottom line.

Walter: Yeah, exactly. That is great. The way I look at this -- and maybe slightly different at the way you look at this -- is we get into this trap and it's really instructive. If anyone has ever seen an auction... Have you ever been to an auction, Darren?

Darren: Yeah, I've got to go to a lot of auctions.

Walter: It's so instructive. If you've ever been to an auction, you'll see what's going on is you know that people walk in there. Does not matter what they are auctioning off but they walk in and plan and go "Look, I am only going to spend x amount". But, what happens?

What happens in the end? When in the heat of the moment, these people start spending much more than they have anticipated or planned for and sometimes you can see like the husband or the wife tagging on his elbow or whatever, "What are you doing?"

What's interesting is that I believe, and I've talked about this a lot in the past in the webinars and things like that about how we get sucked into these basic emotions in the markets and fearing greed, obviously.

People talking about that and these comes up too in the auction. Before the auction, you may walk to an auction and you have a plan. You go "I am only going to spend $1100 on buying this brass monkey" or whatever it is.

"I really like that brass monkey, I'm going to bid on it when it comes up at the auction but $1100 bucks is all I'm going to spend" then at the heat of the moment, you get into this bidding war with somebody and you are really going to have it. Next thing you know once you walk out, you spent $1600 bucks.

My philosophy with trading is to get out of that fear and greed, to get out of that reactionary style of thinking and trading. Instead, move more into the planning area of the brain.

We are not talking about that area of your brain which is basically where emotions lie and where you get really hot headed and revenge and these sorts of things come up, envy. What we are talking about here is planning, using the frontal areas of your brain where you're actually sitting down and going "well, this is what I am going to do" and that sort of thing.

When trading an easy fix is to move away from the lower timeframe where things really happens so fast and you can get caught up in the emotions in the market and then move to a higher timeframe.

That's really an easy fix but when it comes to trading, having a list of -- like a checklist -- of things that you say "Okay, this is what it is going to look like. I have to have all of these things or five out of the seven things in order to take a trade" or whatever it is, and then "I've got to have" -- like you say, having -- "different options for an exit".

That is really a cool way of incorporating some freedom into your system but at the same time, it sits within the confines of what you set out to do and what you've tested so you have different ways of exiting a trade.

All of these things can be laid out in front of you so you are looking at them. When you look at the screen and say "Well, I really want to do this." You look at your checklist, you look at your system and say "Well, does that match up?"

Does the checklist enable me to do this or am I just going with fear and greed here on what is happening? A lot of traders, they run into this. This impulse problem where they know they want to do something, they know it's the right thing to do but they cannot do it.

I believe it's because, in many cases, you'll get lock into that, that fear and greed mode and they are at the auction. They are in the auction, they are in the heat of the

moment, they are trying to win and it's not really about sticking to what you set out to do, your plan, and what you backtested, what you have confidence in.

Instead, you are trying to do something completely different here. That is another thing I think that people... it's so instructive. Go into auction and see what happens, pay attention to what people are doing.

Ask yourself: are they sticking with to their plan or they completely off base here? They've gone off track because they came in with a plan, "This is how much I am going to spend in" and they walk out of there.

You'll see it happens all the time. What do you notice at the auctions? I am curious.

Darren: The same thing, really. People pay much more for items than they intended to. Generally, the auctions I go to, people are trying to buy a bargain. It's kind of antique furniture and reclamation that I go to.

Generally, they are looking to purchase something that they can add value to and sell on. What I do notice there is the professionals, the people who make a living, they've learned their lesson thru probably years of paying too much something because they wanted it, then not making any profit and they sold it on.

Then you got the people who haven't really been around for long. Like you say, get sucked in and are probably going to end up losing money.

I guess that is what's happening in the market everyday because the market is an auction as well. What you are saying about pen and paper is really good. I know it is one of the hardest thing to do is to work with pen and paper when we are in the computer age.

You sat there at the computer and you are expected to go and make notes, and checks stuffs that are written down on the piece of paper but it really does on the psychological level like you say, switches the brain if you refer to something written down by hand.

I do it all the time and I write notes down and I take photos and I send them to people I am working with. I say "I can't read it because it's a myriad." I send them trading roles and it's all myriad so they have to read it backwards and it's just me messing with them.

But it is a really good tool and you need to... Like what I was saying earlier, the edges are so fine and if you are just going to rely on strategic edge, then you're limiting your abilities and you need a bit of a mental edge as well.

You need to be mentally better at adapting than all of the other traders out there. In effect, we are all trading against each other. It's a one on one battle right there. You need to have just these little slim edges that you are working out for over the long run.

Confidence, analysis, getting out of trades early, there is something that we all suffer from but there are simple things to do to correct it. Just start thinking out of the box and stop focusing on just a single element which is your ability to read price action and technical things. You have to start thinking much broader than that.

Walter: Yeah, that is good. That is a great advice. I agree obviously that having a checklist, having the rules in front of you and having your framework and deciding whether or not what you are going to do now, what you are thinking about, that itchy finger you want to take that trade, if that fits with that -- and I talked about this at the workshops -- and when you write stuffs down by hand like Darren is saying, that is a completely different thing to your brain than typing or taking a screenshot.

That is completely different. It is definitely a better way to go. I have this notebook and it's sitting right in front of me and this is where I write down my trades. Basically, I am focused on the execution of the trade, I am not focusing on the results at all. You can go through here and not even know if the system is making money or not.

The other thing I would say, this idea just came to me... What if you as a trader, let's say you are starting out and you are saying "This sounds good, I want to do this. I want to handwrite things down, I want to have my checklist, I want to make sure I've got all my trades under my belt, backtesting live and so forth and so I am confident when I go into this".

Maybe you do what I recommend which is start out with your backtesting and then you go to the small money account then you go to a larger account. It's like you graduate up. Here is one thing that you can think of and adapt this point of view, sometimes it helps me to think in terms of extremes.

Whenever I am trying to figure something out, I'll just say what would be the extreme view be here because it centers you and you can see the rules of the game. Let's say that what we are talking about here, what Darren and I talking about here today, make sense to you. Let's say that you decide "Alright, well what I want to know is what kind of trader... What a trader would look like if he was absolutely like doing everything wrong?"

You know what I mean? List that out. Actually, hand write that out. List out all the characteristics and all the procedures and processes that this trader would follow if he is an absolute idiot.

You know this is that trader out there in the market who is going to pay you. He is going to pay you from his mistakes so I would write down all of those things and now what you have here is like that mere image of what you do not want to be.

You have exactly what you need in terms of building a template for you to follow because you know you do not want to do all of those things. Sometimes, it is easier for us to say what we do not want rather than what we want.

That is one way I think that they help people, too. They just build the idiot trader, build the imperfect trader and work off of that. That could be another great starting place for someone.

Darren: Definitely look what everyone is doing. If most people are losing money, then go and have a look on the retail forums. Read what everyone is doing, examine, analyze their trades and you will notice that most people are making the same problems.

None of us are that unique. We will have the same problems because we are made up basically the same then you can zoom in on eradicating the problems rather than just trying to improve your analysis.

Walter: Cool! Thanks for your time, Darren. I appreciate it. We will see you next time.

Darren: Cheers, Walter! I will see you soon.