

# 2 TRADERS

[EP86: Mindset vs System](#)

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**Darren:** The most important bit to really excel at is the mindset side of things rather than the strategy because that will come with time and when you've got the right mindset and some experiences, you'll develop many strategies that can work...

**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 back to Two Traders. It's Walter here and I've got Darren. Hello, Darren. How are you today?

**Darren:** I am pretty good, Walter. Nice to see you again, hear you.

**Walter:** Yeah, excellent. Hear you. This is the one that we've been thinking about, is the comparison between the two traders. The trader who has a really solid, profitable mindset -- whatever that means -- versus the trader who has a really profitable system. Who's going to come out ahead of here? What's your thought?

**Darren:** Really, I think you'd have to say that both of them are in the same boat because they're both missing one of the important cornerstone. If you are assuming that the trader with the brilliant strategy hasn't got the right trading mindset, then sooner or later he's going to come on stuck because strategies do not work forever and, at some point, you're going to need to make some adjustments or changes.

If you haven't got the right mindset, you are not going to know how to deal with that. You are likely to make mistakes. At the same time, you could argue if you've got a really good trading mindset, and if you haven't got a great strategy then you are not going to make money, anyway.

You could argue, if you've got the right mindset, it is only a matter of time and trial and error before you can hone in on something that is going to work for you. There's 2 parts of the whole. You need the mindset and the strategy.

You can argue that, essentially, good trading strategies are really simple things but understanding what is making those simple things work then being able to implement them to make money consistently is another thing, altogether. So, I'd say they both need each other, really.

**Walter:** Yeah, it's a tricky one. It reminds me of when I was at University, I became aware of a bet. This bet was one of our professors had an assistant and she was like my girlfriend. She told me that this professor had said that there were some discussions which student will do better. Would it be me or this other guy who is my good friend?

Everyone clearly knew that my good friend, he was like the super intelligent guy but he was not really that motivated. Then, there was me. I was like really motivated, I wanted to go to graduate school. I wanted to do a PhD in Psychology but I really didn't have the smart that he had.

The question was -- it was kind of the similar question -- who is going to make it through and get their PhD or do great things or whatever? I mean, I really do not think that I've probably devalued education since I've gone through the whole system.

I think that there are a lot of things that we don't know and we pretend like we know them in the way that we teach students and the things like that. It goes all the way up -- from what I saw -- all the way up to the PhD level.

There's some sort of academic arrogance which I think needs to be squashed out, but that's a totally different discussion. The point is that was a similar bet and what end up happening was, my friend, he didn't make it. He went to graduate school, he got into a bunch of graduate schools, he went into his PhD for one year then, he quit. I obviously eventually got out and did it and all that.

It's an interesting point because it's like he kind of had the system, right? He had this brilliant system which was his brain, his mind, and I didn't have that but I had the motivation, or the desire, or whatever and, equally, he didn't have that.

I do not really know what do you define a success. In this case, it would've been, yes, I suppose getting through and doing, getting your education, getting your piece of paper or whatever. I think if I had to choose -- because I agree. You are right, there's a little bit of loss on both sides, isn't there?

For me, I would probably go with the one that has the mindset. The reason why I say that is because I get a lot of emails from people who say something like this, Darren. I do not know if you've heard this but they'll say something like, "I heard that so and so is making x percentage a month, a week or a day" -- or whatever it is -- "is this even really possible?"

Or, something like, "How much can you make? What's possible to make in the forex market? Can you make the x percentage a day, a year or a week?" or whatever it is. What's clearly happening, and sometimes it's a little bit more obvious than other times, when you read the email, you'll know exactly what's happening here.

The person, the trader, is coming up against their mental barriers because they're saying well, so and so is making 3% a week. That is like a 150% a year, you can't do that or whatever.

What they're not realizing, I believe, is that they are already in a box. Everyone here, everyone listening -- me, you, everyone -- we're already in a box that we've already defined based on our beliefs that this is possible, or that's not possible, you can do this or you can't do that or whatever.

It is hard for us to be aware of this like the fish in the fishbowl. It's like you really don't know where the end of the universe is but it's there. I think, if I had to choose I would rather be the trader that had the mindset and had no clue because in the end that trader would work it out and get through the finish line.

I could be wrong but that's my belief because just because you have a system, doesn't mean it's going to work. There are some traders out there who have good friends who do really, really well trading but they can't make that system work.

I think it's because the system probably doesn't measure up with what they believe in and it also could be that maybe they do not think that it is possible to make the amount of money that their friend is making or whatever. I would have to go with mindest.

I agree, it's tricky. I mean, you do need both. Like the guy with the great mindset, eventually he has to find a trading system but I think he will. I think that eventually he will get it.

**Darren:**

I think it's really difficult to say this is the answer to that question as well because I think that unknown element of the individual comes into it and then you've got elements like luck.

Let's say, for instance, you had a strategy and for the next 5 years. The market conditions will just happen to be perfect for that strategy. You would be assuming that it's your brilliant strategy and your execution that made you all of that money. It might be something completely out of your control.

You are not even factoring to your trading results. There's so many elements like that. It's always, I think the more I learn the more I realize it is very hard to give definitive answers to a lot of the big questions in trading.

It's like a constant pictures constantly changing and shifting and as you become more experienced, you learn to notice that quicker and react to it quicker. It might be that you've got a strategy that allows for those changes and is not affected.

It's really hard to pin down exactly what we need to do to be a trader. Make a living, build a career out of it over a long time but certainly, mindset and strategy are the kind of two big bull parts.

**Walter:** Yeah. Like for example, if you had somebody who had no rules or guidelines or anything and you're just in there picking off trades, I mean we could both probably see where it's going to go. Especially if you are not familiar with the emotions of the market, you can just get obliterated.

Many of us who've done that who basically come in and said, "Well, where is the CHF going today? Is CHF going up or going down? I'll just figure that out and take the trade." That system doesn't just work.

**Darren:** The thing is we all think we've got a good trading mindset as well because we're not going to think that we haven't. There's sort of people that are involved in trading generally consider ourselves to be a little bit smarter than we are and a little bit more skilled and our strategy to be better than it actually is even if we've got data that disagrees with that.

Do you know when if you've got a good mindset or not? You might think you have but you might be making mistakes and then glossing over them to make yourself feel better. All of that stuff is going on in the background as well.

**Walter:** Yeah, absolutely. The big one is -- this is the big thing that we all do when we talk about other people -- is the fundamental attribution errors where you say so and so. If you do not know someone well or if it's not you and you say, "So and so did that because he is an idiot. That is why he did that, he's an idiot." So, you blame the person, their personality, it's the characteristic of the person.

If you know them or if it's you, you'll say "I did that" or "My brother did that because it was raining outside. That is why he did that. He was not trying to be an idiot, it was just raining. It's the situation he was in." You blame the environment or the situation.

The same thing, I think, can happen with your trading system to your point which is that if you have a trading system and you believe in it, you'll say, "Well, this is a great trading system, has a 62% win rate blah, blah, blah. Makes 2:1 reward to risk blah, blah, blah" and all these stuff and then someone points out, "Wait a minute, what happened last year, it was basically break even. What are you talking about?"

"Oh! Last year was a tough year. The market was choppy." You know what I mean? So, you are blaming the situation and that drifts through like in life. You'll notice people, we do that all day long.

If someone close to us will make excuses and blame the situation and if a trading system is close to us, we'll make excuses, we'll blame the situation. But, when it comes down to it, if we don't know them or don't like them or we don't like a trading system, then we're to say that it's inherently wrong or bad or poor or whatever.

That is something to be aware of. People, that is how we think and it's a tricky one to get away from. I guess the best thing is just to be aware that you're doing it and know, "Yeah, okay, this fundamental attribution error is slowly sneaking into my thinking".

**Darren:** Yeah. And, on the subject of the strategy side of thing, is there such a thing really as a strategy that all you need to do is implement the strategy and it's always going to work? Can you build enough rules in there that it will work out the market conditions of whether to trade or not trade?

When to adjust your take profit, how much risk, can you build all of that based around rules or is that even possible? At some point, there's the need to be that discretion, as what we call it. That sort of feel and that gut feel, "The market looks like today but I am not feeling these entries so I'm going to leave it and do those little elements".

What I am saying is, do the successful traders just have these innate ability to feel the market?

**Walter:** Yeah. The programmers, the guys who are running EAs and robots, they'll tell you that you can do that. You can create a system that does all that but I think the good ones will tell you that it's usually like, it's usually simple rules that work.

In other words, they don't have all these rules like don't do this if it's Friday morning, and do this if the volatility is too much. It's more simple stuff, I think, from what I understand which makes sense, right? It makes sense.

**Darren:** Yeah, and they will be more robust but our natural inclination is to not believe that. Even when you know it's not true that more complex systems are less robusts, your gut feeling leads you to believe, "Oh! If I just had a rule to gauge the trend, that will make all of the difference." And we just feel, we're missing one extra rule rather than accepting that all approach is going to have periods of winning and losing.

If you've got a good approach and a good mindset and the market conditions are right, then you stand a good chance to making profit. I mean, this is why. As much as I love backtesting, I am really dubious about giving too much weight to the results because it's just showing you, "Okay, in this period, if you've traded that rule set you would've either done well or bad. This is what your drawdown would've be." But, going forward, then you're going to be presented with -- it might even look like exactly the same market conditions but there might just be a slight variance in that that's probably probed things out so you do have to stay nimble, on your feet.

My trading period last year just absolutely sucked and, at the same time, we were doing lots of backtesting. All the backtesting said that long term expectancy is really good for

this but there are periods where it doesn't work too well and there's drawdowns but they're never that bad.

Even coming into this year, it's really struggling to make consistent profits, winning at some and giving it back. You just cannot do that backtest, get a good backtest result and think, "Okay, my work here is done." It's just isn't going to be like that.

Even when you are settled on how you want to trade and you work on your mindset, you need to be aware that there are some point down the line, you're going to have to make more difficult decisions and you're going to perhaps have to make changes. It's like a completely ongoing scenario.

It certainly is for me -- you might disagree with me, Walter, but that is how I am sort of picturing trading as I go forward.

**Walter:** I think the thing to guard against -- and I strongly believe that this is an issue for many traders -- is they will adapt and change based on a really small sample size. I think that is a big mistake.

For example, if I say January was crap, January was really bad for my system, "Well, how many trades did I take in January?" Does that mean because I had 15 bad trades in January, do I need to redevelop and change and morph the system that I've been trading for ten years and I backtest it over 900 trades and blah, blah, blah? Is that really what I need to do?

Or, like I said or do I scratch up to, "Okay, this is just a bad month," and we know that those happens like you were saying. I think too many traders make the mistake of taking short term point of view where they look at maybe the last trade, or the last five trades, or the last ten trades and then, they decide that based on what happened there, they need to change something.

I think the key is to look at it in chunks; chunks of 50 trades, chunks of a 100 trades. Look at the chunks and then we can probably talk about this idea on a different podcast but, the real comparison to see if things are going well is whether or not the chunk of data that you have is acceptable within the range that you would accept as coming from the same population that your backtested result or your past results came from. Does that make sense? That is how I see it.

**Darren:** Yeah. And that is not really something that you can strategize or say that falls into the realms of having the right mindset, basically. The right understanding of how the market works and what it really is and what you can expect from your strategy. That is a mindset thing.

**Walter:** Yeah. But, what a lot of traders will do is they'll go, "Okay, January was crap so I'm going to add these filter if it's below the 50 moving average" or "Okay, will the weekly chart is going to have to identify the trend for me so, then I'll drop down to my lower timeframe."

They do things like that and say, "Wait, wait you spent these many trades, trading it, done this much testing now all of a sudden January was crap so you're going to throw it out the window?" That, to me, is crazy.

Maybe I am not quick enough to dump a system that's gone bad -- we can probably talk about this in our next episodes if you want where we'll talk about how do you know when a system stops working.

For me, I would rather rely on the big, the bulk of the data that I have and just stay on the course rather than to adjust on the fly which I think is something that it's really tempting to do specially when you're in a drawdown. It is really tempting to scroll back and go, "Okay, hang on. What if I've done this?" and that is how you add too many rules to a system in my estimation.

**Darren:** I see more and more traders have been around and achieved some level of consistency. I do see a lot of them now when they're having a bad period, having a break at least. I think that it is just much to be able to sort of consider what is going on and have a bit of breather rather than making some bad decisions by continuing to trade. That's not the strategy wouldn't protect them but I think, really, more of a mindset thing again where they have a perhaps larger string of losses than is as usual.

They just have a bit of a breather as sabbatical from the charts, if you like. I follow a trader who trades gold, who's been solidly good for 4 or 5 years and then just recently, he's taken some large losses and a couple of them. He's just having a break from that.

I think that can be quite a good rule to sort of add. I think his maximum loss is 7% and he had 2 of these 7% losses which is quite a large loss for his monthly gains. He's just having a complete break.

Sometimes, that can be a good rule to add and I think the idea is that what you should do is just keep trading because you've got your backtest and this is a normal drawdown. It should come good but there aren't to be said for having that mental break from it and just taking all the risk off the table for a bit.

Taking a breath, consider the results and the losses with a clear mind and then coming back to it. I think a simple rule like that sometimes work and, like you say, the worse thing to do is just instantly chuck the strategy out and then continue trading with another strategy because you are more likely to make a lot of mistakes there.

**Walter:** Yeah, I agree. What I used to do was if I had a drawdown, I go, "Okay, I am not going to trade, I am just going to go backtest." But, what I found was I've come to the same idea which is it's actually a better idea to simply don't backtest, don't even look at the chart.

The more time I spent away from the charts, the better I am when I see the chart. I think it is worth it to take even if it's just 3-4 days away from the charts. When you see them again, it's like it's fresh because you'll have some theories. Like, if you look at the charts, say, for you for example in the London timezone.

If you go, "Alright, I'm going to go to sleep and I have a pretty good idea of what might happen overnight during the Asian Session so when I wake up, I'll have a pretty good idea of it's probably it's either going to do this or that but that's probably it. They're just going to do this and that."

You wake up and you'll look and say, "Yup, there it is. It did what I am expecting" and then you can fire off your trades. But, what happens when you are away from the charts 3 or 4 days, things have happened and it's in totally different spot than it was before and everything is fresh.

It's almost like you don't have any skin in the game. You don't really have any expectations. That is what I like about not looking at the charts during Asia. If I'd just look at the charts in the morning and then I don't look at them until London open, I really like that because I don't really know what happens during Asia.

It's nice to see them from a fresh perspective when London opens. I've noticed that the longer I can stay away from the charts, the better off I am when I actually sit down and look at the chart. I don't know if that's normal but that is how it is for me.

**Darren:** Yeah. Do we, in general, spend too much time talking and thinking about trading? Do we trade too much? Is it too straining on the brain and amount of time and thought process we put in it? Do we need to do more than having a break, like you say?

**Walter:** Yeah, probably. I mean, I think it's like many things. After a while, you just cannot maintain that vigilance. After a while, if you're driving through the guts of Australia, after a while, staying on that straight road that you've been on for 3 days or whatever, it's tough to stay between the lines.

I think it's the same thing with trading. You can maintain that focus for so long and then after a while, it's just not going to work. I think that is why the best scalpers, they have really rigid rules about the times that they are going to trade.

They are going to trade between this hour, in this hour, and they are going to take x number of trades maximum and that sort of thing. They are very regimented and I think that other traders can learn from that.

I don't think that it's a mistake that a lot of these traders who trade shorter timeframes, they sort of have background in the athletics or something like that where they're very disciplined and very focused and able to get into the right mindset.

I find that fascinating, I agree. I think that, overall, we could probably do a lot of good if we were just able to give ourselves a break and a freshen things up even if it just means like maybe you don't just look at one chart.

For example, maybe you really like trading the Kiwi. Maybe you don't even look at the USD/NZD for a month and then you come back and look at it after a month where you've literally have no idea where it is at.

Things like that can really help too. I would stress to listeners that -- and it's really hard when you first start trading -- you want to read everything about trading. You want to learn everything you can about trading.

As you farther down the line, you get to the point where you feel like you just need to focus and you need to be really, really on when you are focusing and after that, it doesn't really matter.

Just got an email this morning from a trader who, he said, "I'm leaving the private forum. Here's why: starting to get really big winning trades and I just learned that I need to rely on myself and I do not want get distracted. It's easy to see all these different things and get distracted".

I completely agree. I thought, for him, it was a great decision. He's been working at this for a long time and he's finally got to that point where he feels like he knows he can rely on himself. He knows he can make it work. He just needs to focus and stay away from all the stuff on the edges.

I thought that was a great idea but these are the sorts of things that they come with time, with experiences, I suppose as well as traders.

**Darren:**

Definitely. I do suffer from that. Sometimes, I just need to stop all of the talks, stop reading the articles, just stop watching the videos and the webinars and just completely switch off for me. You get this information overload and stuff that you didn't even want to be taking into account.

You've kind of, looking in, it's slipping into the back of your mind when you are trading. So, yeah, you definitely need that break. We agreed really that the most important bit to really excel at is the mindset side of things rather than the strategy because that will come with time.

When you've got the right mindset and some experience, you'll develop many strategies that can work. Are we in agreement now, that it's the mindset?

**Walter:** Yeah.

**Darren:** Cool. So, what is the best way to get a good trading mindset? What is the quickest way?

**Walter:** What is the quickest way? I think it's to think like a casino because a casino doesn't care if they have a 2% edge at the slot machine. If the one arm bandits or the pokeys, as they call them here in Australia, if they pay out 98% of the money that goes through there but the casino is just keeping 2%, they know that it's okay.

It is the same thing for a trader. The trader has a 1:1 risk to reward ratio and has a 52% win rate, that trader has that sort of slim 2% edge but that is the mindset that you need, that you have to keep as a trader: keeping that long term focus and not worried about the last 10 trades. Not worried about the last month, last week or the last day, that does not matter. What matters is the long term performance and that you focus on execution.

To me, having that long term point of view and the focus on execution, that's what works for trading. If you get away from that and you've got sloppy with your execution, or you change it up and so you are changing the way you are executing, in other words, changing your system, or if you are too focused on the immediate recent results, I think that is where you run into trouble.

It's like playing a game. You know that a certain number of times, you're going to roll the dice and it's going to come up great and you are going to win and sometimes you are going to lose. You just know that you need to keep rolling that dice.

I know that there's the issue that you are probably going to bring up which is you might run into a situation where your system doesn't work anymore. We can talk about that in a future podcast. That is definitely an issue. You cannot keep rolling the dice if the system is broken and that is a concern.

**Darren:** Yeah. And systems do stop working as well, don't they?

**Walter:** Yeah, specially the ones that have more moving parts. It's like that idea that you've brought up in a long, long ago podcast, right? The anti-fragile idea that the book is a

really robust thing and the -- not the iPad, was it the kindle? The kindle can break down because it has so many different parts and weaknesses and things like that.

Whereas, the book is fairly robust. I think the same thing goes for system. It doesn't mean they won't breakdown, it just means that the simple robust system that says that you can explain in one sentence is probably going to be better off than the one that has two paragraphs and if then, caveat this and caveat that, that sort of stuff.

What do you think, Darren? What would you say to that? How do you get that mindset?

**Darren:** I think there's a lot of ways that you can learn it from. There's a lot of information out there in the internet, books you can read, good forums you can join with other traders and chat with them teach you a lot but I think if I needed to say if I was going to teach my daughter to trade, I would tell her to keep a journal.

To keep it like a daily diary about how your trading went, what mistakes you made, what your results were and I think that that is the quickest way to learn the pitfalls and where you're making the mistakes as a simple tool you can use. And so, for instance, if the problem with your mindset is that you were always taking profit early, you might be doing that for a long time and not even gotten on to the fact that that was happening.

If you keep a daily journal or some sort of record keeping of this -- these websites has now ultimate spreadsheets and really good for journaling. If you use them properly, you read them and you use the data that they are giving you, you'll realize quickly that there's certain mistakes that you're prone to that's specific to you. I think that that is really a good way of improving your trading mindset.

**Walter:** Excellent. Thanks for that, Darren. I really appreciate it. I look forward to next time. Maybe we can talk about systems that stops working and how you'll know that your system is time to be buried. Maybe we can talk about that next time.

**Darren:** Cool! Okay, Walter. See you soon.

**Walter:** See you.

