

2 TRADERS

[EP91: Emotional Gut Response \(Part 2 of 2\)](#)

Walter: If you're going to try and use intuition and gut in your trading as an experienced trader, and you believe that you have an edge there that is going to help you, I would say track it. Test it and see if you're right, that's basically it...

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: In this episode, Part Two, we are going to talk about a few interesting things that counterproductive thing every trader thinks about when entering a trade and why this is counterproductive. What you can do about it.

Why Darren is uncomfortable when I am the most comfortable during the process of a trade and vice versa. When following your rules can be absolutely devastating to your bottomline, Darren does a really good job explaining this.

How to build up a profitable trader's gut and what this means. It's pretty funny. Everytime I hear that, I think of a "it could be your gut" but really it's a trader's intuition as what we're talking about there.

Finally, the best starting place for new traders trying to create a trading system. All of these and more in Episode 91, which is Part Two of The Two Traders Podcast.

Walter: Where do you think that comes from? Is it from experience from looking at so many thousands and thousands of charts and seeing that and sort of throwing that into a category in your head whether unconsciously or whatever. You see it and you think this doesn't look right because you've seen that pattern so often. Where is it? Where does it come from?

Darren: I don't know. I mean, I still sort of go back and do testing a lot and I know the system is solid but that always comes in there. I think it's just a natural fear of the uncertainty, basically. Because, regardless of the backtesting, you still want every trade to win even though it is not going to and you know that the outcome is uncertain so that kind of fear is always there probably under the surface.

Do you get that? Do you get that even when, "Okay, this is a perfect setup" and you're going to place a trade? No matter what, you'll still get that low level anxiety about the outcome?

Walter: That is a great question. I know when I take the trade, my rule is I won't take the trade unless it's one of those situation where I just can't walk away from the computer

without taking the trade. Like, I feel I am missing out on a party or something. You know what I mean?

That is my rule but the uncertainty and fear and all that, that comes in when it's an open position. For me, it's not the placing of the trade because I have a high bar where I need to feel like I am missing out. I've trained myself not to over-trade.

I should mention that because for a lot of traders, at least for me, they feel like they're missing out every hour so they'll just going to keep taking trades but for me, I've trained myself. So, it's like I know I am not going to take very many trades this week, if any and if I do take it, it's sort of like, "Aww! I really don't want to take... That's too good to pass up."

And then what's happen for me is the management is the key part because once I am in the trade, now I've got to go to the other side of it which is.. In the beginning, it's filtering. "No good, no good, no good.. Whoop! We have a winner. I'll use that one, I will take that trade."

In the beginning, it's really being picky, for me anyway, and then once when it's in the trade, it's moving to defense. Switching sides and going, "Okay", because the main decision I have to make now is when do I move my stop loss to breakeven. How long can I wait with risk on the table? That is the way I'll look at it.

That is the real nervous part for me. It's just that from open position to break even for me, that's the soft part, so to speak in my psyche, I guess.

Darren: That's interesting because I am almost the complete opposite of that.

Walter: I know.

Darren: I'm never more comfortable than when I'm in the trade. Once a trade is triggered and I'm in, I really don't care about it anymore. I don't care whether it goes to TP or stops out or hits a few pips on my TP, I don't mind. I'm just really calm with it and at ease with it but whenever I'm placing the trade, I have this anxiety and that's when I'm most likely to make a mistake.

I actually did it this week. Actually, I was pissed off with myself about it. I left 2 valid trades and those both went pretty much straight to TP this week so it's kind of weird. That's our personalities creeping in to the way we're trading.

That's probably why we've ended up trading the way that we do rather than on any particular amazing edge. We've just found the one that fits with us.

Walter: Exactly. That is what I'm going to say. Your personality has defined your trading for you, hasn't it? For me, the biggest issue is how do I get to break even? Has it gone far enough for me to move to break even?

Once I hit that, I am okay to letting it unfold from there. That's cool because I feel like, well, the worst thing that you can do is hit break even and it's like I never took the trade but I've put all of the focus. You have all the focus on extracting profit like the management I suppose or the work that you're doing with your trade is extracting profit from an open trade.

The work that I do is filtering out...

Darren: Selecting it.

Walter: Yeah, selecting it. It's exactly the opposite, you're right. It's almost like my trade management, once I get to break even, it's almost like that's pretty mechanical. I do not have to worry about it.

Whereas, with you it's exactly the opposite, isn't it? Because your mechanical part is the entry.

Darren: Yeah. I mean, what I used to hate was waiting for a specific rule to be met so I could take an entry and watching the last few minutes on the bar and then it's one pip or two pips on the wrong side. It didn't meet the entry criteria and then you have to leave it. That was just crushing for me. I couldn't deal with that.

I cannot trade with those sort of strict rules for the entry. I've got to find some way where I can just trade every bar, if you like. I am not saying I trade every bar but where there this not so strict criteria that the shape and the pattern of the bar have to meet.

For instance, say, you had to wait for a particular level to be hit. If you've just missed it, that was just too much for me to take but what am I supposed to do? I like everything else about this but I missed the level by 5 pips. Am I going to leave it? That does not make sense to me. I just couldn't deal with that. I have to build a way of entering that that remove that.

Walter: I know, I understand. Some people would be completely happy to not take the trade that missed the critical, it missed becoming a signal by a few pips, by a pip or two. Some people would just be like, letter of the law, I am not going to take it.

Whereas, you have a more open approach or you are more forgiving for rules and things like that.

Darren: Yeah. My brain was trying to justify what the difference was in those 2 pips. Can they really make a difference over the next forty-eight hours or not? Maybe they can but for me, I cannot marry those two things up in my mind.

Here's the thing though. If we know essentially what elements are going to make a system work for you long term, how do we find out without five years of pain and strife? What are these elements that are going to work for you because we have just worked out there? The way of trading we've made worked for ourselves has been largely based on our personalities. Is there a way of finding this out without just going through years and years of failing?

Walter: That is a great question, isn't it? For me, it was years and years of failing and that's how it works but I think now, at least with forex traders, where there's so many ideas and systems out there that you can taste test and see what makes sense to you.

To me, that is the key. If I were a new trader coming into this, what I would do is I would definitely go, "Okay, I've worked out but of all the systems, I like the idea of a break out." I like the idea of getting in when the market opens in New York, for example. That is what I like to trade because I see strong moves there that makes sense.

These are the sorts of things that traders need to do. If you're new, align yourself with an idea, core concept that makes sense to you. Then, from there you can build it out. From there, you can decide am I going to hold the trade over the weekend? Am I going to hold it for several days and weeks or am I going to be in and out?

That will help you with the timeframe and then do -- I like the idea of milking huge winners? Am I happy to have targets and more easy to achieve in and out sort of thing? Or, is it really important to me to have huge winners a couple of times a year, a month or whatever, maybe use a trailing exit?

All of these pieces fall into place once you decide what is important to you and I think it is a process. It's certainly not something that you can do quickly. I think I can tell by giving people some charts.

If I give a trader some chart and say, "What's going on here? What would you like to do? Would you like to buy or sell here?" I think you can whittle it down and figure out. Am I a reversal trader? Am I a breakout trader? Am I a trend trader?

All of those sorts of things I think become obvious if you show people the same charts and say, "What would you be more likely to do here?" But that doesn't really help you decide what kind of system you want.

The good news is there's so many books out there, trading books. When I started in trading forex, I was reading stocks systems because there aren't any forex books. There was one forex book and that was it.

It was like all the stuff that I learned like the patterns stuff I learned them from [Thomas Bulkowski](#) who had this huge volumes of patterns. He had all these data and everything that he'd run through the stock markets. He had all these percentages and everything which was pretty useless to me as a trader who is interested in forex but at least it gave me an idea. "Well, I'll have a look at that one".

It's a tricky thing, isn't it? I think, sometimes we evolve and we say in the beginning that we're going to trade for targets and take profit targets but then in the end we decide it's too painful for me to sit through these trades that'll go an extra 600 pips beyond my target. So, I am going to use some sort of a trailing exit or split my position so that I'll have a target and a trailing exit or something like that.

I think it is a process. I agree, I think it is a process but you can shortcut the process today by aligning yourself with somebody on the forum or a trader in a book or someone, some system that you really like. It resonates and it makes sense and so now, that's the starting spot. It shouldn't be duplicate of what they do, that is not going to work but it should be, "Okay, I get it, this makes sense. Why don't I just tweak this so that it'll be perfect for me."

Darren: Yeah. There's some arguments as well that, that process of learning and losing holds benefits further down the line as well because maybe that is where the gut comes from. It's that longer experience of specific events and results that build up to be your gut in the end. So, if you really did shortcut it and had a way to sort of test it, that would be the perfect way. You might actually missed out on some sort of important lessons there.

Walter: To sort of wrapping this up, this idea with traders, what do we do as traders? Do we pay attention to that intuition or do we build it out? Do we test it? I suppose what you could do. One thing that you could do like if you have a trading journal where you track your trades, you can rate them on like a intuitive scale.

Say, "How much do I like this trade" and now you have data. You can go back and test it and see, "How right am I? Am I right when I have a winner here? Is it something that really makes... do I have an edge? Does my intuition gives me an edge or not?" Because you can certainly track that. Is that something that you do?

Darren: Something that I don't do enough of because I am too lazy, Walter, but it would be a really good idea to run the two side by side and say, "Okay, this is what I am going to do here but my intuition, what would my results would've been if I've used that and

compare to see if there is an edge there". That would be really useful, someone should do.

Walter: Yeah, I think that makes sense. It's interesting. If you're really a discretionary trader like I am, maybe really the focus should be on the other elements of the trade. For me, like I said, my real critical part is the decision to move to break even.

What I could do is to track that. I probably should be doing that where I track that decision and say, "When I moved to break even, do I feel like I'm gonna be popped out at break even? Do I feel like I've moved it too early or do I feel pretty good about moving to break even here?"

That might just be random noise but it could also highlight something, a consistent mistake that I am making or something like that with my decision there because it can really be painful when you have a good trade and you move to break even so soon that when it retraces back, it pops you out of the trade and then it goes exactly as you expected.

There's several really painful outcomes in trading. One is, of course, having the loser but I think the most painful one of them all is missing out on a trade that you knew was going to be a good trade but you missed out, whether you didn't take it or you took it, just got stopped out at breakeven too soon. Those are the sorts of things that are painful.

Darren: Yeah, especially if it was your decision you made that got you stopped out which is kind of the damn fool with the discretion thing. If you're leaving it down to discretion when you move to breakeven, then you're going to beat yourself up about making the wrong decisions on those ones where you've got stopped out.

On the other hand, if you've got a very systematic way of moving to break even and you notice that if your settings were slightly different, you would've had a much better period. You can end up in a period of constantly changing your settings.

Walter: Exactly.

Darren: There's no way here, really. You're never going to remove, you'll never going to sort of hit optimum strategy all the time. There's just going to be periods where your approach, whether it be discretionary or systematic, just sucks and that happened for me last year.

If I would've continued to trade through this year in exactly the same way, I'd be having a much better performance as it is. I've tweaked what I was doing and just sort of added

a little bit discretion in there. You'll never going to be able to escape it and that's one frustrating thing about trading.

Walter: Yeah, absolutely. We just have to take ownership of it and say, "Okay, alright." Like you say, you're either going to beat yourself up over your decision or keep changing your settings so that it would've done really, really well on the last trade. Unfortunately, that last trade is all done and it's been booked. It is a crazy cycle.

I keep coming back to this idea that I think makes a lot of sense which is to simply let your, as a part of your system, let the trade decide what the best decision is and split it up so that if you have several ways to get out of a trade and it's still the same trade, eventually one of them is going to be really, really right. You'll feel like you've done well here.

One of our friends, this is what he does, he has a target of one to one so he's risking a dollar to make dollar. He's got a two to one target and then he uses a trailing exit. It's nice because in a way, if the trade really, really runs for him then his trailing exit is probably going to make good money and, of course, the other targets will be hit. So, that's the best case.

If the trade goes a little waste for him then, it's just going to hit the one to one and the other two positions aren't going to do much. Trailing exit probably won't make much and then the two to one, obviously, is probably going to be break even result so it's a washed.

These sorts of things make sense because it's almost like not making a decision. You'll just throw your hands up and say, "Look, I do not know what is going to happen when I get in this trade but if it really, really goes, I want to take advantage of that. If it just goes a little ways, I want to take advantage of that." It's like you're betting on all the numbers on the roulette table.

Darren: Yeah, I like this approach. It's unlikely to be the optimum approach but it works and it's consistent. I have a programmer who's saying, "If you'll run backtest, you should never pick the best setting," because the best setting is probably going to be the least robust over a long period of time and you should pick like the second or the third setting and then explore that one.

I feel it's the same with trading approach. I think two of them were trying to be optimum, were trying to have the best result, the biggest winners, the least amount of losers all the time.

Whereas, a more realistic and maybe robust approach is to find something that has a consistency but it is not necessarily optimum all the time.

Walter: That's absolutely right and that's just really what we have to deal with. In the end, the focus shifts, doesn't it? For the experienced trader, the focus shifts from trying to make the system perfect, trying to make as much profit as possible in any given situation and it shifts to me, the trader.

How do I deal with this? How I do give myself permission to be wrong and give myself permission to miss out on these big trades? It becomes more about introspection and working on yourself rather than trying to build this perfect Holy Grail system.

Darren: Okay. Sum up, Walter, going back to the original subject.

Walter: Yeah.

Darren: Use gut only intuition or not?

Walter: I would say, if you're new to trading, I would say you can use your intuition, just flip it. I would say if you're going to try and use intuition and gut in your trading as an experienced trader, you believe that you have an edge there and that is going to help you, I would say, track it.

Track it, test it and see if you are right. That's basically it and be aware of the confirmation bias. One way to get around confirmation bias, because as an experienced trader, like you say, "I'll use my gut and I'm going to look at the facts". The problem with the facts is sometimes you'll only look at the facts to support your hypotheses.

What I would say, if you're going to do that, try to write out two.. so you have two columns. On the left column, you write down all the reasons why you're right or you think this trade is going to work out the way you think, based on your gut. Your gut says, "Buy the Euro" you write down all the facts.

Then, on the other column, on the right hand column, write down all the reasons why another trader would look at the same chart, the same exact thing and think the opposite and think that it's the perfect time for the Euro to sell.

See if you can see the other side because those other traders are the ones that you're going to take money from so, you better make sure that they're wrong. Just try and take it from there. You know what I mean?

Like, if this trade works out for you, those are the guys that are wrong, can you tell why it is the case? Why they're looking at and thinking something completely different? Why are they thinking something completely different? That's important. To sum up, that's what I would say.

Darren: Yeah. I can't disagree with it, any of that, Walter. Use it but use it carefully.

Walter: Yup, definitely. Alright, I look forward to seeing you next time, Darren. Thanks for your time and we will see you soon.

Darren: Okay. Thanks, Walter!

Walter: Bye!