EP92: The Intuitive Trader (Part 1 of 2)

Darren: Sometimes we avoid the fact that the system is failing it's most likely going to be you or a change in the market conditions or you shouldn't be trading the system in the first place...

Announcer: Two Traders, Darren and Walter, pull back the curtain on profitable trading systems, consistent money management, and profitable psychological triggers. Welcome to the Two Traders Podcast.

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

Darren: Good evening, Walter.

Walter: I've got this idea and it came from a book called "**The Intuitive Trader". I am going to post a link on this in the show notes for this episode** so that you guys can check the book if you want.

This is not even from the book. It's from the preface of the book and the idea here is that -- I'll read you a quote here. It says:

"Too often traders lose sight of the key to success in trading. They convince themselves that success can be found in a head and shoulder pattern or a black box system. The more expensive, the better or over the daily hotline or the latest trading guru. What these traders start forgetting or choosing to ignore is that successful trading begins and ends with self-awareness and most traders, particularly novices, resist this notion."

So, what are your thoughts on that? I think that brings up a whole huge pile of ideas.

Darren: I agree with these on one level. This idea of self-awareness is really important because you need to know what your weaknesses are, where you're going to make your mistakes.

The only conflict I have with this is Algo Traders and very systematic traders: how are they using self-awareness in that type of trading?

Walter: Well, can I take a stab at this?

Darren: Yeah, go for it.

Walter: Like for example, Mark Fletcher is in our Forum and he runs Algo Trades. Algorithms are trading for him. He's a really good programmer and kind of expensive but he's really good.

He writes down this debate, "I would argue that all traders are discretionary traders in the end because they managed their algos even if they're not physically taking the trades and they're managing their algos."

He used to argue to the other side. It's come to my point of view because he's found himself managing his algo. I guess, when you're an algo trader, the management is different.

It's a different type of discretion. It's not a discretion in sort of when am I going to buy and sell because that's all been quoted up and it's in the program. But, the discretion comes in and the idea of when do I turn it off? When is the market moved, when it's become too weird, when is it..? This news has come out, has ruined my system, or it's not making it a favorable market so they are doing a lot of managing.

If you talked to real algo traders, they'll tell you that it's a different type of work. They're always watching to, making sure that it's chugging along, making sure that the server is up, and making sure everything is going in the backups and then everything is happening. They also, in the moment of truth, will admit that they have to decide whether to turn them on or off. To me, that is where their work is, that's where their intuition comes in.

Darren: So, it is a number's game but that game is constantly evolving. And, at some point you're going to be have to make decisions outside of those numbers, isn't it?

Walter: Yeah. I mean, for example algo traders, they have rules or they should have rules. When do you scrap a system? Is it after it doesn't make money for a full year? Is it after 50% drawdown? Is it after x number of losers in a row? They have a lot of data that they used to build that system and to forward-test that system and there's all different ways to doing that, walk forward and all these stuff.

The point is they have an idea in their head when the system is broken or when the market is changed so the system doesn't work. And so, what is that? What is that line in the sand for the algo traders?

I think, they'll tell you this system go bad and then they have to break it, they have to turn it off or use their discretion. "Election is coming I'm going to turn it off." Who's going to win in France or in the US or in the UK, whatever it is.

These guys, they still step in front of their system even though they'll tell you that the reason why they are an algo traders, to remove the emotion from the equation. Well, I hate to say it but they still have to deal with their emotion.

So, what does that mean? How do you become a better trader by becoming more self-aware? That's the core idea, I guess, for this episode. I know you are a big fan of journaling, right?

Darren: Yeah. I think the data can help point you to those psychological flaws that you might have. Say for instance, if your average risk/reward is less than the system you tested, then that journaling might point you towards that and that might lead you to realize that perhaps you're closing out your trades just before they hit TP or something like that. You gloss over that fact.

I think journaling can point you to the areas where you are failing and it can help you do that self-examination and realize a flaw because we're really good at hiding these flaws, for me. I often see people post a question in a forum which, from an outsider when you read the question, you can clearly see areas where these traders probably are going wrong.

For him, even though he's got that data, he's not locked on to that fact and I think journaling sometimes kind of writes it off in a bit of paper, right in front of your eyes and then you cannot miss it.

Walter: It activates an area of our brain that we don't use anymore. We're always on our smart phones or watching the screen or whatever, it's completely different. Children today they don't even learn how to write, they just know how to type. It is an interesting experiment.

I think there's a lot of value in that, anyone who's done it can see that, when you're writing it. What point of view do you write? Do you write like, "I thought this and I did that"? Or, do you write it like, "Then, the market did this and the market did that"? What's your perspective when you write it down?

Darren: Mine is very much from just the hard data, really. So, let's say we've just finished a week of trading and I do a backtest on that week using my system and see what my result should've been. If my actual results are way off then, somewhere in the execution, the part where I get involved in executing the system is going wrong.

For me, it's very much comparing how the system performs and how I've performed but it doesn't have to be that way. It depends on how you trade and if your system is more analytical and uses more discretion, and you are having to analyze the market condition, and you're making mistakes then, describing how you are feeling and why you make the decision you did would be of more use to that sort of trading.

Walter: Absolutely. One of the things that fascinates me about the way you trade is the hedging so I guess, I should probably leave that for another episode. But is that part of your,

when you're taking a record, is it part of the record? Like, "I hedged here and this is what the result was." That sort of thing?

Darren: No, because the market decides if I hedge or not so that is not something that I'm making a decision. Really, I'm looking at the elements where my decisions are making a difference and then that generally is when I decide to take a profit.

Walter: Yeah, the exit.

Darren: Yeah, it's the exit for me.

Walter: So, if you get stopped out, that's not really a decision. It's that the market has decided to hit your stop loss, yes?

Darren: Yes, that's just the inevitable part of the way I trade and, likewise, the hedging so that's all very mechanical for me. The only bit, really, that I'm making decision on it is the actual management of the trade because I don't like to pick a direction.

I like to work on a premise that the market is going to move and when it does, I'm in a trade and then it's how I manage that trade that decides whether it's long or short.

Walter: Okay. What's interesting is, there's no element of, "Well, the market has been really choppy and hasn't moved very far, very fast recently so it's due for a breakout." That's not really part of your... You know it's coming, you just don't know when so you just keep going, just keep chopping.

Darren: Yeah, essentially. It's that movement and then consolidation movement that I try to capitalize on but it should be said that I've come to trade that way because of some self-examination. Because, I realized that being analytical about the direction or particular setups that I want to take on or not take didn't really work for me.

I tried to make it work for me but it didn't fit with my personality. I discovered that and because of that, that is why I started trading in a different manner. It is this idea of finding out what you're good at, where you're bad at, that led me to trade the way I am.

I think that is where he's getting at here, isn't it?

Walter: Yeah. So, my question for you is, is there something that you recognized in yourself? Was it a conscious belief like, "Look, you cannot really pick the market. You just need to be in when the market is moving."Was that the core thing, that core awareness of that idea that was so strong that led you to trade the way you do?

Or, where there more subtle elements that you noticed in your trading and said, "Well, I keep doing this, maybe I should do that"?

Darren: Yeah. It was fairly obvious that I was making the same mistake over and over again. Even when I was aware that this is a problem I have, I was still making the same mistake.

I almost physically couldn't stop myself making that mistake. I've discovered a flaw in my personality dealing with a particular way of trading. Rather than trying to remove that, I tried to work with it and say, "Okay, this is the element I have trouble with. Can I make an edge from trading without using that at all?" That is how I approached the problem rather than trying to change myself, I try to get a strategy that fit in my personality better.

Walter: That's interesting.

Darren: Does that make sense?

Walter: Yeah, that makes sense. It was sort of like going with the way that you're naturally kept bending that way anyway so you just go with it.

Darren: Yeah. I mean, it's hard to do because, generally, everyone says you have to trade in an analytical directional way. You have to look at what has happened, make assumptions from that, assume what the direction is going to be, and how far is it going to go and that is how you'll trade.

I am not saying that's the only way of trading that's out there but I'd say the majority of trading is based around that core concept and it's very difficult to say there must other ways of making profit in the market.

For me, switching to a line chart, it's something I used to do a lot. It did make me look at it a bit different. It's quite easy to get dazzled by the candles, you start reading more into them than what's there.

I am not saying they can't be used to trade successfully but, for me, that was a negative and I needed to find an edge somewhere else in the market basically.

Walter: It makes perfect sense. One of the things that's interesting to me about this is that there are two levels. When you say that, like the quote where we're basing this episode "successful trading begins and ends with self-awareness," I would ask what's the type of awareness are we talking about here?

There is this idea in psychology, that we have these subconscious thoughts and it's not only an idea but we've seen these sorts of things measured in a laboratory where the

lab technician knows 6 seconds before you make a decision on what are you going to do. The reason why is because he sees it flash up in your brain with the functional MRI.

These sorts of things, there are some decisions or some influences and some directions that we move and later on, we come up with a theory. Later on, we come up with the reasons why we did it but really it was something else. Something completely else.

It's because grandma drop you when you were two or something. You know what I mean? That's why you kept closing your trades too early. What do you think about that? I know we've talked about this before and I am a big proponent of working on your subconscious and trying to stuff some good stuff in there instead of just letting it be whatever happened to you when you were growing up and just go with that.

I am just curious, what are your thoughts on that? We've talked about this in the past, is that something that you sort of encompass in the self-awareness category?

Darren: Yeah, definitely. It's a long way of being an expert on that subject and from my own personal experience, I believe that to be true. When you see that people cannot copy successful traders way of trading and also be successful.

I'm not saying they can't but many people find it difficult to copy. If a trader that's doing really well even though they've known the system then there has to be something else going on because if you look at the black and white of it, most systems are pretty straightforward and simple.

You're drawing out execution over time where these personal biases and personalities are going to play out. That's not obvious when someone is teaching you a system or you're reading a thread about a system. You don't really experience it then. It's in the drawn out weeks and weeks of trading that your personality is going to start to play out and affect it.

Definitely, this idea that how we were brought up and how we deal with authority figures, all of those things are going to affect this sort of trader that you're going to be.

Walter: Do you think there's an element of, sort of... Well, you take a lot of breaks during the year, don't you? I mean, is there an element of sort of being too vigilant for too long or too confident for too long or losing your confidence because of losing streaks? Is that part of the deal here?

Darren: Certainly for me, I take a month off every three months and I still do a little bit of trading on that month off but it's not really my primary focus anymore. I'm sort of thinking about switching off from trading so I think we, perhaps, think too much about it and we try too hard. I definitely need those breaks.

Walter: Absolutely. I think that could be an element that we record in our journal where you have a confidence thing like -- just not confidence in the particular trade. If you're discretionary like I am, then this makes sense. But, if you're just taking every turn in the market as you are more mechanical with your entry, it'll probably doesn't make sense to rate the trader itself, right? Maybe, I don't know.

Maybe you can rate the exit or something. But, for a trader who is taking a lot of trades, maybe you could rate sort of your overall confidence and your ability to find profitable trade. You could track them over time and see that, "Are you prone to making more mistakes when your confidence is not an all time high?"

If your winners made some money over the last two weeks, now you are more likely to make mistakes. Or, is it just reversion to the mean in terms of the market is going to give you a few losers now? It doesn't have anything to do with you but instead, it actually just a statistical anomaly. All of these are really interesting.

Darren: I think when people lose confidence, as well, they tend to lose confidence or put it into their system so they see the system as being the element that's failing which is probably rarely the case because if the system is failing, then it would've failed in backtesting and probably wouldn't have worked up to that point.

I think, sometimes, we can't avoid the fact that if the system is failing, it's most likely going to be you, or a change in the market conditions, or you shouldn't be trading the system in the first place.

Walter: Yeah. And, another big one I've noticed is that people tend to get overconfident and then they change the risk parameters. That's a big one, isn't it? You're doing really well, you've been trading this new system over the three months. You look back and say, "Wow! I've only been risking 1% per trade. If I have been risking 2%, look at how much money I would have made." So, of course then, they switch to the 2% risk and that's when they hit the losing streak. But that's another thing, isn't it?

Where you're tweaking it, not really trading what you set out to trade by and that comes into risk levers that we fit it with. I think that is also an interesting way where being aware of that, being aware of the fact that you're getting really confident now, and you want to take twice the risk.

Darren: They'll know it's a loss. As soon as people up their size, they have their worst period ever and I suppose -- I don't know what's happening there. We up in our size because we're just kind of overconfident rather that the system isn't actually performing.

When you backtest your system, it should work out what is the right position size for that system to risk and should that change or just stay the same.

Walter: That's all we have today for the Intuitive Trader Part One but in the next episode, Part Two of the Intuitive Trader here at Two Traders Podcast, you're going to hear about why the first $100 Million account is different for almost all traders and it has nothing to do with the liquidity available to you as a trader.

You'll also see three ways to improve your trading Psychology in the next episode, Part Two. Why most trading forms have this type of Psychology subsection in the forum, it's almost universal.

How you can tell what trading stage you're in by simply looking at this one thing. Darren will show you why most traders are wrong in estimating this critical aspect of your trading and there are two authors that you should definitely be aware of, if this episode highlight some interesting concept for you so, we will reveal those as well in Part Two.

Hope to see you in the next episode, Episode 93 of the Two Traders Podcast. See you soon.