EP56: Two Traders, Four Questions (Part 2 of 2)

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Darren: But if you have too many choices, too many options and too many elements to consider, our ability to make a good decision is reduced....

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: This is part two. If you have not listened to the part one, then please go back and do that. This is part two, Episode 56 of The Two Traders Podcast. In this episode, we are going to talk about fishing and trading, spearfishing and trading, spearing a friend, spearing a fish and why institutional traders, such as the traders at banks and hedge funds, have one huge headache or a problem.

All these and more in today's episode.

Walter: Alright, Darren. We've got another question here from another trader. This is the third of four and this question is: I need to find time to trade with my work schedule.

This is a big one and to me it screams out. You are probably looking at trading as sitting down, busting out a few trades, and then going to sleep or whatever.

Maybe just shifting to a higher time frame is the right way to approach this. Maybe what you need to do is get to the point where you can sit down in over fifteen to thirty minutes, just adjust your trades or have a look.

Make sure everything is going well and then go on with your life. Come back the next day for fifteen to thirty minutes and do the same thing instead of thinking of trading as something that you sit down and do for four hours or something like that.

It sounds like this person is quite busy and my gut feeling is looking at the higher time frames daily, weekly, eight-hour charts, something like that. That is probably going to be your answer here but I will be interested to hear what you have to say.

Darren: I think so, as well. They've got an aversion to the higher timeframes. The people who are most against, perhaps trading daily time frames, when they do actually switch tend to do a lot better.

Quite a few of the traders I have worked with have moved to daily time frame because of the time zone they are in. It is not just about work schedule, it is about when you are trading And if you are trading on the lower time frames, you really need to be there when the market is moving.

If you cannot be around for the London or the New York session then trading the lower time frame is going to be when price is moving and it's reacting to levels. If you can not be around, then you are putting yourself for an instant disadvantage.

That is quite easy to see. If you just visually look at a sixty-minute chart or thirty-minute chart, you can clearly see what parts of the day when price is most active. Even if you are deciding to hold those trades for a long time, you will see that the price reaches the extreme and turns around when it's the most trading.

If you step back and think about it logically, that is exactly what you would expect it to do. Definitely, it is a case of going to the higher time frame and there is no way around it, really.

If you do try and find the way around it, you tend to be putting yourself at disadvantage before you start. It might be uncomfortable moving to those slower time frames but, trading is about becoming comfortable with a lot of things that are naturally uncomfortable for you.

Move up to a higher time frame if you want more action then just add more instruments and, at the same time, keep an eye on your risk levels if you do that.

Walter: One of things that I think I am always trying to think of analogies for traders who are a bit concerned about moving to the higher time frames. The big concern is "Well, my account is too small so I can not have that stop loss placement on my weekly chart." That is not really an excuse anymore.

There are enough brokers out there who will enable you to set your own lot sizes. You don't have to have standard lot sizes or mini lots or even a micro lots. There are brokers who offer the opportunity for you to trade any size so that is not really an issue.

I think to me, it is a concern and it's just crossed over. Trading the lower time frames is completely a different animal and you touched on this because you mentioned that some of your traders, they do a lot better when they move to a higher time frames.

I mean, to me, that's an obvious thing. If I am fishing okay, what do I do when I go fishing? I will throw a line out, will sit, and wait. Maybe a few minutes or hours from now, something is going to happen.

I do not really have to do a whole lot of thinking. I do not really have to do a whole lot imagining. I will just going to hold that fishing pole.

Now, from a spear fisher it is a completely different situation because I am making these adjustments. Sort of I am watching that fish and I do not know if he is going to move left or if he is going to move right.

I am getting ready to spear him in and it sort of in the moment thing and then he moved left then he moves right then I got to spear him. This is really an intense thing. That is not the same as just throwing a line out there and waiting for a nibble.

This is the difference between trading the five-minute charts and trading the daily charts. Things slow down when you trade the higher time frames and it is a little bit more forgiving.

If I am trading the five-minute charts, I can almost guarantee you that if it is a losing trade it is going to hit my stop loss. I am probably not going to get out of the trade before it hits my stop.

If I am trading the daily charts, it is a pretty good chance -- or the weekly charts -- it is a pretty good chance if the trade goes pear-shaped. I am probably going to be able to adjust it and pull out with that trade if I want to long before my stop was hit. Then it might seem like a really big deal but it is, if you look at the map behind that because now it means that the amount that I am risking per trade is actually wrong.

If I am averaging a stop loss or a losing trade that does not go all the way to my stop loss. That means if I am saying that I am going to risk one percent per trade in this trading system, maybe my actual trading results are that I am only risking zero point seventy five percent per trade because I have been able to pull out of this losing trades long before they hit my stop because they just look really bad.

Now, the whole idea of whether you are going to set and forget, put your trades in and walk away and let it hit your stop or hit your profit, or get out of your trailing exit or whatever, that is a whole different discussion.

I just want to point out that there are lot of differences and it is in your brain, basically. The differences between trading those lower time frames and higher time frames is a totally different thing that happens in your brain. The only analogy that I come up with right now is difference between the spearfishing and just fishing with the line.

One of my friends told me the story where he is to the spear fish and went out to Western Australia, where I guess the spearfishing is pretty good, and he was telling me the story where he was diving there. Freediving.

He had this spear gun and he was going to get this fish. Somehow, the fish had been stabbed or hit or something and it could only swim in a circle. So, this fish was swimming in a circle and he was down there freediving with his friend. He said he really want get this big fat fish with his gun and it kept going on a circle.

It could not get away and he was just running in a circle. He was aiming his gun to his fish and he's like "Okay, I am going to get it. I've got it in my sights". But, as the fish was going in a circle, his friend was blurring by as well.

He was like okay, if I shoot now, I am going to my shoot my friend. "Okay now, I am going to shoot the fish -- friend -- fish". It was really difficult decision whether or not to fire off the gun because he does not want to nail his friend.

That is the thing that happens when you are trading lower time frames. You have this difficulty knowing what to do and it so much easy when the clock slows down for you when you are trading the higher time frame.

That is my theory behind why more traders find success trading the higher time frames. That is what I think is going on. It could be different but if you've got a job or if you've got a busy life, like a family and a job and whatever else is going on, you've got soft balls on Thursday night and all that stuff.

Whatever is going on in your life, if you've got too much the easiest way is to just shift your focus to the higher time frames, check out the weekly's or the daily's or something like that.

You can look at the two-day charts. You know that you can trade the two-day charts. You can trade a forty-eight-hour charts if you want, or twelve-hour chart. Whatever you want, these can be done. I would definitely try and do something like that. I think that that is probably going to be your solutions so hopefully that helps.

Darren: I think the illusion of control comes in with it as well on the lower time frames. If we are more active in our open trades, we somehow feel like we've got more affect on the outcome of those trades.

Generally, it is a bad habit and I would say "completely untrue" as well. I see a lot with that when I am trading the four-hour charts and I talked to traders about it. They say if you are trading a four-hour chart, there is going to be some buzz that you are going to miss because you are sleeping

Traders would want to know that "what bar I am missing?" What happens if they miss a different bar? Really, it does not make any difference because let's say, I am awake and there is an exit for me and profit, so I will take that profit.

If I was asleep, there is much likelihood in a style I trade that that trade is going to go to a more profit, is going to retrace. The small details that we see as being really significant in general are not.

We have this bias that by not being there, the price is necessarily -- or your trade is necessarily -- going to go against you. In other words, when you missed something, this could only be a negative outcome from that. Whereas, really it can go in your favor as much as it can go against you.

I often see that I will miss a four-hour bar when I am trading four-hours, it just went above me and I will just say “okay, I will just let it go for another four hours.” As often as not, it would be a good decision as a bad decision. So the small details that feels significant, they often don’t, they are often not.

Walter: You are not suggesting that traders sleep three hours and fifty minutes so they can get in that next four-hour candle?

Darren: When I trade the sixty-minute chart some days, I will start an hour later and I will get a message “Why did you trade the eight-hour bar, the eight am bar?” I was like “Well, I decided to stay an hour more in bed”.

It can be significant but the point I am trying to make is you should question those points that you feel really significant because often you will find that really they do not make any difference at all.

Walter: That is a good point and the other thing I want to dig into is this idea of the illusion of controls. Can you expand a little bit on that? You are saying that traders... I think this is an interesting idea that a lot of people probably have not thought of which is: Why is it that we feel like when we are trading the lower time frames, that we have more of an affect on the outcome?

Darren: I think because we can make more decisions on the lower time frame. We feel like we are getting more information. I think that is probably a visual thing when we look at a candlestick chart.

Whereas, if you were looking at a line chart then it probably would not affect you so much. What I mean is so, we are in a trade, we will see a single bar close against us, say on the fifteen-minute chart.

We, as traders believe that we can take that information and make a decision that will affect the outcome in our favor. That is not borne out in reality and in effect you are more likely to make, with more information, just more bad decisions.

In your trading, look for ways of reducing the amount of decisions that you have to make because, in a trading environment ,we are just not good with making those decisions.

Walter: To drive home this point, I was speaking to two traders last week. One of them had a bank and the other one had a hedge fund. They said exactly that, what you just said Darren, which is some of the biggest problem they have is they've got information overload.

These guys have so much information that comes in from their work and they are on their Bloomberg News feed on their phones. You've got so much going on. It is like it is really difficult for them to know a lot.

It is like paralysis by analysis and they have learned over time to focus in on what is important. This is something that I know we get into when we talk about fundamental analysis but I think you are absolutely right and that's a really good point, which is that information sometimes does not help.

Darren: When restaurants design menus now, good restaurants, they look at this. This high people who make decisions, they've found out that if you put more than seven or eleven items on a menu, people can't make a decision because they've got too many choices. They've also found that where you place certain items on the menu will make a difference of how popular they are.

We think that we are always making rational and good decisions and that is true to a point but if you have too many choices and too many options and too many elements to consider, our ability to make a good decision is reduced.

If that is how it is just deciding what are you going to order for lunch or dinner then imagine what it is when you are risking a thousand dollars on a trade and you evaluate yourself with the decisions.

Walter: Absolutely, that is a great point. It's funny that you mentioned that because I always think of that when I go to a restaurant. I think "Okay, let's see how smart they are". How smart are they going to be about this?

You open up your menu and your right, you will see like twenty seven items and this is crazy. It probably makes it difficult on the restaurant because they get to a point where they've got too much stock for certain recipe and now that is going to go on special.

Whereas, if you are focusing on four or five things that you do really well, it is just so much better for everyone: the customers, the patrons of the restaurant and the chefs in the business.

It makes a whole lot of sense and that is great, that is a really great point, Darren. When I see those restaurants and they have too many, I just think I'm just making a big mistakes here.

It is just not the right thing to do and you can see this in a lot of different areas where you were offered like these seven different phone plans or whatever, really what they want to do is -- if they are really savvy -- is they will boil it down to "do you want this or do you want this?" There is going to be two or maybe three options and other than that, it is just really does not make a whole lot of sense.

Darren: Your trading should definitely be that way. You should distill it down. Like I was saying before, consider what really is significant and just boil it down into a very simple entry, choices. Very simple management choices then, ultimately simple choices when you exit.

You need a little bit flexibility in that but you don't want to overload it. If you want to use analysis then again distill it down, consider three or four points that is most important and just use them. Do not just keep adding more and more information because it will just confuse you. You will make bad decisions and you get in that spiraling of giving your money away.

Walter: Just for the last point here, I just have to share the M&M experiments. They did this experiment with M&Ms, and this speaks to your idea here, Darren. About this idea of having too many choices.

They gave the people in study a bowl of green M&Ms. Give people a bowl of green M&Ms and they will eat certain amount. We know that if you've got a green M&M or red M&M or yellow one, they all taste the same. Do they taste any different to you, Darren?

Darren: No. They are all the same, Walter.

Walter: Of course, they are the same. If they give you a bowl of all the colors, the brown and the yellow or the green, everything, we eat twenty to forty percent more. I do not know why.

Do you feel like you are missing out? We feel like we've got to get more variety. It is the same thing that is going on here when you have too many choices and you feel like you are missing out. You feel like you've got to get in on everything.

Why do people eat twenty to forty percent more M&Ms just because there is more colors out there? Because their choice is too many there and we feel like we need to really get in at everything.

That is why people overeat when they go to the buffet. Buffet is really popular in the United States. I do not know how popular are they over there in England, Darren, but they are really popular in the United States.

Darren: They used to do this with the penguin biscuits. You've got penguin biscuits, which is just like chocolate biscuit. You've got a multi pack of six and each biscuit was a different color and the big joke was: what color is yours?

They are essentially the same biscuits in the different wrappers. I wonder if that is what they are doing just to make us eat more than we wanted by putting them on different colored wrappers.

Walter: They probably knew exactly what they are doing.

Darren: Yeah.

Walter: Alright. Last question, Darren. This is the fourth question of our four-questions here. This is a support and resistance question. What is the relationship between the time frame you are looking at and the time frame that you should be trading?

Darren: I am not a hundred percent sure what the listener is getting at here.

Walter: I do not know. My guess is what is happening here is, this person is having -- has seen too many support and resistance on the chart -- and because there is too many support and resistance on the chart, trying to figure out which time frame should I be looking at to set my zones and then drop down on a different time frame and trade. I do not know but that is my guess here. I think that is what is going on.

Darren: I think with the time frame thing, again, you should just distill it down, make it simple. When I used to trade support and resistance and multiple time frames, what I like to do was use a higher time frame for the over trend and then a lower time frame to enter.

Then, go back to the higher time frame for my targets. It just didn't give you any particular edge but what it did was make you, kind of force you to have a higher risk/reward trade.

So, I will be using say the daily or the weekly levels and then entering on the sixty-minute or the fifteen-minute charts. If just forces you to say "Okay, what I am going to do is I am going to trade a higher risk/reward strategy here."

I do not think that there is any particular edge between the different time frames from my point of view. I was just using it as a tool to force myself to make better exit decisions. Certainly, if you are looking at more than two time frames and support and resistance in all of them and considering all of them in your decision process, I think you just over complicating it and not really giving yourself any extra or giving yourself any advantage.

Walter: The easy solution here is you go up one so if you are trading the one-hour chart, you go up in the daily, draw your support and resistance zones in there. If you are looking at the daily chart, you can draw your zones on in the weekly, that is the kind of thing.

Even if you are trading like the sixty-minute chart, you can still draw your support and resistance zones on the chart with the weekly chart then wait for the sixty-minute to give you a trade. Wait for the sixty-minute to approach any of those levels. That is not necessarily like, a bad thing to do.

I think the number one problem that people have when they are trading support and resistance is that they have too many. The easiest way to get out of that is to simply shift to a higher time frame, make sure that you've got all the ones that you think is really important, lock those in and wait. Go down to your time frame that you are going to trade and wait to get in there.

It is what you are saying that by doing that, if you are using support and resistance for exits as well as profit targets, then this is going to help you out because they are going to be pretty far apart. They are not going to be really close by and that is going to force you to wait before you get into those further spots on the charts. That's, of course, going to bump up your reward/risk ratio. That is really a good point.

Darren: I find, quite often, what traders would do was they trade like a specific system of time frames with support and resistance. They'd get into a trade and then they'd have an emotion of what would come up also within that trade.

Let's say, a bar close against them or something and then they'd go looking for a reason to get out of it and break their rules. They'd say "Well, I've looked at the four-hour chart… Oh, this is a support and resistance there. Okay, I am right to have this feeling. I will get out."

In effect, they've carved, fit it in their analysis to comfort that badly emotional feeling they are having. They are feeling fear, they will go and find a technical reason to go along with that, and then break their rules. It's a bad habit to get into.

You have to accept that support and resistance are like a guide for action. They are a point to, like you say, to wait for the price action to get there then you go for your process of entry or exit or management. Let the trade do what it wants to do and you cannot really control that by, you cannot always find a reason, so sometimes, it is not a good idea to go looking for it. You just need to go with the process and let the numbers play out.

Walter: That is a great advice. I really appreciate that. That is a great advice for everyone listening. There are a lot of things you said there that are unpacked and one of the thing that struck me, Darren, was when you said "it is a reason to break your rules".

I think we probably could have an episode just on that: reasons to break your rules, pros and cons, why or why not? Why you should or should not break your rules? I think that might be the topic for the next podcast if you agree on that. What do you think about that?

Darren: Yes. Let us do that next week, Walter.

Walter: Sounds great! Alright, thanks so much for your time, Darren, and thanks to those of you listening. I wish you a wonderful and a happy trading week. See you next time. See you, Darren.

Darren: Cheers, Walter! Thank you.