
Why Trading Psychology Confuses You More – Part 1

# The How of Trading

In school, did you ever study something and end up more confused? For some, trading psychology has that effect. The more they learned, the more they would become confused. Actually, the standard advice is well-meaning and can be appealing on some levels. "Be more disciplined". "Get in the zone". Who can argue with that? Who wouldn't want to do that?! Instead, most traders are struggling to close the gap between where they are and where they want to be. They know what they want, but they can't quite get there. What to do? Ultimately, trading psychology should help us do two things: 1. Help us to identify problematic areas with ourselves that negatively impact our trading. 2. Solve them.

» If you're spending time "solving" problems that aren't relevant to your trading, or implementing solutions that don't work, then you are going to get confused. Instead, you should work on things that make you a better trader.

And you know what — confusion doesn't help you to get better at trading.

With this in mind, how do we find out the best advice and block out the stuff that confuses us?

### Why Trading Advice Is Not Useful

1. There are a few problems that we typically run into when dealing with trading psychology advice, it doesn't even address the problem.
2. If it does, it doesn't work.
3. If it does work, then it doesn't work...for you.

### 1. It Doesn't Address the Problem

If you're unsatisfied with your results, or really hungering to take it to the next level, then you wouldn't expect this one. But if you really think about it, most stuff on trading psychology falls into this camp. The reasoning is very simple:

Most trading "psychology" issues are not about psychology — they are about poor trading. For instance, you'll often hear newbie traders who were in a losing position say "they couldn't take the heat", and so panicked and closed the position. Thus, they conclude, they need to "work on their psychology".

But this is not a psychological problem, even though they may feel bad for having taken the loss. Rather, it's a trading problem — if you take too much risk, then you get scared a lot more easily! And if you don't have a good stop-loss or risk management policy, then you will end up closing out positions at emotional "pain points", not necessarily at the right levels.

What the trader in this situation needs to do is to go back to the drawing board with their system – they need to have in place firm risk management guidelines, including a pre-defined stop-loss. The reason that you pre-define is to remove the emotion from it – if the order is in the book already, then the decision is somewhat detached from the actual moment, where you could panic or backslide or whatever.

Afterwards, this trader would need to cut down the risk that he is taking. Obviously, by reducing the risks that you take, you will be better able to handle psychologically the inevitable fluctuations in account size. You are much less likely to panic, because you will be in a more comfortable place emotionally.

To put it in numbers, if risking three per cent of your equity on any given trade is causing you heart palpitations, discomfort and causing you to make bad decisions, then change something! Start by risking just one per cent. This minimises the chances of you having a disastrous drawdown. If you are risking four per cent on any given trade, then a string of five losers would see your account down almost 20 per cent – a stinging drawdown. On the other hand, if you are risking only one per cent, then you could weather ten losing trades in a row and still be OK. Risk is the paramount concern—if you're panicking, or merely uncomfortable, then take less risk.

The outgrowth of this is that you can only talk about trading psychology after you've gone through this exercise with every aspect of your investment approach. First you need to know what to do; it's only when you can't pull the trigger or can't stick to your well-honed trading model that you should start to think it's a psychological issue. Any discussion about psychology can only come after a thorough discussion of trading, and it must be grounded in the universal fundamentals of good trading.

When trading psychology talk doesn't proceed from a thorough discussion of trading itself, then it ends up confusing you more. You can do a lot of exercises for "confronting your fears" and "getting in the zone", but if your trading is sloppy, then your results will still be bad and this work will only confuse and frustrate you more. If you are generally happy with your results but want to take it to next level, then you can't do any psychological work in isolation; rather, you need to focus on what you are already doing well and drill down to find the areas where you could improve; only then does the psychological work help you to reinforce that work.

### 2. Its Advice that Doesn't Work

A lot of the advice we get is quite vague and general, along the lines of "Be more disciplined", "Focus on a positive outcome", and "Get an understanding of your childhood traumas and everything will be ok". This advice doesn't work because it's quite simplistic. What's missing is the answer to my favourite question: "How?"

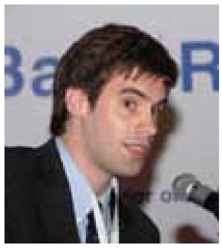
No, the real reason we turn to trading psychology is not because we don't recognise the need to be more disciplined or to make other changes – rather, it's because we realise the need and are trying to find out "How" to be more disciplined. If "trying harder" would get us there, then most of us would long ago have hit our goals and escaped our frustrations. In this case, we want guidelines or specific instructions, not just extolling the virtues that discipline gives to your trading. Willpower alone is almost never enough – we want to know "how" to overcome our internal barriers and resistance, and to build new habits that can help us in our achievement of the goals.

Another important, related consideration is that the "How" has to work. I'm not sure which is worse – pithy advice with nothing additional to help you achieve it, or concrete advice that doesn't help you to get there. Only use tools that are proven to work or that work in other fields – like CBT (Cognitive Behavioural Therapy) in the world of therapy, or techniques used in the sports world. What we want is a solution to a goal or problem. Advice without the "How" will actually end up frustrating us, because we are in the awkward situation of knowing *better* what we want and where we need to go, yet feeling less empowered because we don't have the tools to achieve it! Without the "How", we're doomed to struggle to get to the right outcome — causing us plenty of confusion.

If you've ever taken a look at self-development books, from any field, a lot of them offer good ideas. The advice can be a reformulation of a tested and proven idea – for instance, the power of visualisation applied to wealth, e.g. "Think and Grow Rich". Alternatively, it can be a completely innovative idea within a field that hasn't been explored – think of '"Switch or Change or Die", which address the field of changework. Either way, these books succeed not just because of the ideas that they offer, but also because they contain very specific, actionable steps that explain "how" to accomplish certain goals. It is only by spelling out the "How" that we can move from just an idea into real, tangible progress.

### Stay Tuned for Part 2

In part 2 of this series, we'll focus on the third reason why trading advice is not useful. In addition, we'll discuss the solution for what traders actually need to do in order to improve. «



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