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DON'T BE YOUR OWN WORST ENEMY: Beat Mental Barriers to Successful Trading

by: *Barbara Stevens*

More important than profiting on the green days is getting through the red days and knowing that you can work through it.

Whoever coined the phrase “we are our own worst enemy” must have been a trader. As an active trader for ten years, a moderator in a few large online trading rooms, and a trader’s mentor and coach, I think I’ve experienced or heard almost every scenario that results in lack of self-confidence, bruised ego, indecision and failure.

To an outsider, trading looks simple. You just go long when the market is going up and short when it’s going down. You’re an instant winner. With robot-like efficiency, we would all enter trades at exactly the right time as the price moves to our target, and then we would exit at precisely the right moment. All of this would be done without any emotion or stress. No sweaty palms, rapid heartbeat or self-doubt. Snappy, objective decisions would rule the day as profits poured into our accounts.

Unfortunately, we don’t behave like machines, and we live in the real world of human fallibility. We have to cope with a wide range of emotional and psychological baggage that we bring to trading. If you’re easily stressed out when things don’t go your way, don’t expect to be the epitome of calm as a trader. We are who we are. Part of our ongoing task as traders is to deal with weaknesses that impede our success and use our strengths to our advantage.

I’ve worked with traders who had an exceptional grasp of objective, precise methods, but still they were unsuccessful. What is it within each of us that makes consistent trading so elusive? After years of trading, teaching and talking to traders, and watching them cycle through the daily emotional highs and lows, I have learned what emotional and psychological issues are common – and perhaps more importantly, how to develop some strategies to overcome or work around these issues.

The “I-Can’t-Be-Wrong” Syndrome

There really is no logic in thinking that we’re always going to be right about anything. We’re reminded of that daily by family, colleagues and, most certainly, by the markets. Investors and money managers floating in the profits of the Internet bubble

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seemed to be under the illusion that the bubble would just keep expanding. When the bubble finally burst, very few came forward to say they were wrong. How many considered if it was even logical to think things would go up forever? Wasn't it just easier to believe that these stocks would recover than to admit we were wrong, sell our shares and profit at least a little (or lose only a little). Don't think you're going to outsmart the market. The market is always right.

I've met so many traders who refuse to get out of a losing trade because they don't want to accept being outsmarted by the market, fail to interpret the method correctly, or mismanage the trade. Many traders have encountered this problem, especially in the early stages of trading. For some, it isn't just the need to be right but rather a matter of ego. Often from childhood, many individuals equate being right as praiseworthy and being wrong as worthy only of punishment. To keep our self-esteem intact, we have to be right or cling to the hope that, in the end, we will be correct and our ego can escape unscathed. That might work under some circumstances where the worst consequence is to lose face, but when dealing with the market, the consequence will be to lose money. The longer you stubbornly cling to your ego-driven need to be right, the more money you're going to lose. Eventually you'll be so "right" that your account will be gone and the market finally will have convinced you who's the boss.

After the "I-can't-be-wrong" syndrome has caused numerous losses, we must face reality (or the end of our trading career). It isn't a moment of sudden clarity accompanied by the blinding white light of an epiphany but rather a slow awakening to the fact that if we want to remain in trading, we better figure out a way to read the market. If we can do that with objectivity rather than personal bias, we then can preserve what's left of our confidence and really start trading. We don't have to like being wrong; we just have to accept it as part of the learning process.

To accept being wrong while keeping confidence intact – and losses under control – we each need a plan, and part of that plan should be protective stops (or stop losses). By being in charge of your stop and making that decision based on your parameters for risk/reward, account size and money management, it's still possible to satisfy your need to be right. If the trade goes against you, you will have made the decision to correct the situation by using a trade plan suited to your personality. It will allow you to exit the trade – self-esteem intact. Just as important, avoid purely mental stops because it's too easy to fall back into those emotional patterns of wanting to be right; then we end up losing too much.

Overtraders Anonymous

You know who you are even if you don't want to tell the rest of the world. You just can't pass up the opportunity to trade. Many justify overtrading by claiming they're scalpers – so it's part of their trading style. For some that's true, and they do it successfully with precision and planning. But even scalpers are guilty of revenge or boredom trading. Your trade diary will tell you if you are scalping

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real signals or not. Also included in this club are the gamblers, adrenaline junkies, those with no self-control or discipline, and those hoping to make the “big score” as fast as possible in spite of what their method is telling them.

Trading isn't a contest to see who can make the most trades per day or the fastest profits in the shortest period of time. Trading is about evaluating the risk/reward of each trade with objectivity, using your method, personal trade plan and money management plan.

Some traders take a few losses and then are overwhelmed with the need not only to make up for losing trades but also to achieve their daily goal. That's stress. They begin to see what they want to see instead of the reality of the situation. Under these conditions, many traders not only will take iffy trades, but they'll take many more trades than usual because they're forcing themselves to make up losses. When that type of emotion gets in the way of objectivity, very few can distinguish the right parameters for good trading. This distinguishes successful, experienced traders from the others. They don't make trades just for the sake of trading.

Nobody wants to admit being part of the overtraders club, so how do you break the cycle?

First, if you can't sit at the computer without the compelling urge to trade, then walk away when the market is slow or too choppy for your style or ability. Nobody can maintain focus for the entire trading day without a break, so divide the day into segments for trading, study and breaks. Learn which parameters yield the best risk/reward, which signals or patterns account for the best profits and the worst losses, and which hours you can be most productive. Take advantage of those productive hours and become more selective during other hours if you must trade. No matter how many trades you make, the focus should be on protecting profits and becoming consistent.

Don't use the excuse that you make a lot of trades because your style is very aggressive. A profit-and-loss statement will reveal whether you are trading aggressively or just overtrading. Be honest about why you take each trade, and note those reasons in a trade diary; doing so will help you develop greater restraint. Remember that many people say they become traders to have more free time. If that's true for you, then ask yourself why you sit at the computer for so many hours trading any market that's open. Maybe trading has become an obsession instead of a job. Only you and your family can determine how much is too much.

The Big D – Discipline

Discipline is essential in trading and one of the most difficult personal issues with which to contend because we each have individual psychological issues that determine self-control. Each aspect of a trade involves discipline from learning a particular method to execution of that method, which includes entries, stops, exits, number of shares or contracts, risk/reward parameters,

money and time management. It would be easy if this was a one-size-fits-all endeavor, but we have many different strengths and weaknesses. You might not be able to overcome the fear of making a mistake, but you can establish discipline guidelines when that mistake is made. I've seen too many traders blow up their accounts because they couldn't follow their own rules.

Discipline not only means keeping your emotions in check, but also taking the time necessary to learn the method you choose. Study, ask questions, observe the method and test it in simulation before trading with real money. Discipline in trading is much like in sports. Golfers practice their golf swing until it becomes automatic, and the smart ones don't compete until their skills are up to the challenge. Try different methods until you find what suits you.

One of the ways to discover what method works best for you is to keep a trading journal to include not only your actual trades but also your emotional and psychological reactions. You might find that having to constantly evaluate and calculate Fib numbers isn't working for you, but watching visual patterns or moving average crosses is exactly what you need. Keep in mind that whatever method or combination works best for you, success will still be predicated on the discipline to execute the rules of that method.

While working on your method, also learn to establish a set of rules to evaluate risk/reward and how that risk could impact your account. This is part of keeping a trading journal and establishing money management. A trading journal will help you discover your strengths and weaknesses as well as help in developing trading guidelines. You'll realize that it's just as important to know when not to trade as when to take the trade. Learn to trade more conservatively early in your career to build good habits and establish a more secure financial base. Remember that rules are only as good as the discipline; we have to use them consistently so don't make them unrealistic. Don't sabotage yourself by setting goals that aren't practical. Preserving capital is essential in preserving self-esteem, and discipline is the key to building a trader's confidence and financial success.

Along with keeping a trading journal, good money management is a key factor in maintaining discipline. Without going into the specifics, money management would include rules controlling how much you're willing to risk before you even enter a trade. To be successful and to develop confidence in trading, the odds must be in your favor. With proper money management, you can have a few controlled losses, be profitable on the day and maintain self-esteem. While the purpose of trading is to make profits and increase your account, the purpose of money management is to preserve your capital with established parameters of an acceptable risk/reward ratio.

Anais Nin said, "We can't see things as they are, we see things as we are..." To develop the self-control necessary to make objective trading decisions based on the market – not our subjective, biased sense of reality – we have to learn about ourselves. Because bias

interferes with objectivity, you may not be aware that you aren't seeing what's actually happening. This causes traders to stay in a trade in spite of the fact that the trade plan dictates otherwise. It also encourages greed, which in turn clouds expectations and realistic goals. Without discipline, bias and greed will spur bad trading decisions and limit the flexibility needed to exit a losing position. You'll still be concentrating on what might have been instead of getting ready to focus on the next opportunity.

For some, that overwhelming drive for unrealistic profits will result in filling an emotional void with material rewards, thus increasing the stress level to an unmanageable point. Discipline can help traders maintain a realistic perspective about their trading and themselves, rather than holding this type of perspective: If you make a good trade, then you're a good person; people will admire and accept you. But if you make a bad trade, the perception is that you're not a good person and not worthy of admiration.

Accepting Wins and Losses

Research that explores "loss aversion" points up the fact that people hate losing money more than they enjoy winning. In fact, those who spend time with groups of traders truly do observe that many experience a lower low in losing than the high they enjoy as a winner. Eventually, through discipline, we learn to accept winning and losing with a degree of equilibrium, so confidence won't hang in the balance on each trade.

There are many other issues that could be explored where those things that make us who we are conflict with the traits we need to become successful traders, but space is limited to this discussion. The search for success not only is related to trading techniques, but also to the fascinating journey of self-discovery we travel as we reach for that success.

Unique traits and emotional/psychological issues exist within us because of who are (and were) as individuals before we became traders. The solutions spelled out above will not necessarily eliminate what makes us unique, but they will help us discover ways to make personality work for us.



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