

## Trading Psychology - Developing A Trading Psychology Plan

Barry Lutz

### Tactical Trading

A number of months ago there was an interview in Stocks Futures Options magazine called [Demons Of Trading Can Shrink Your Potential](#). The interview was intended as a discussion of the mind games involved with trading - below is an excerpt. After reading this I considered how many times I had heard and used the words *trading plan*, but not the words *trading psychology plan*.

John Smith (not his real name) came to me after a year of watching the markets. He said he wanted to support himself by day trading the E-mini S & P. He had only taken three or four trades in the past year. His proven system offered him 15 to 20 trades a day and made money on paper. He had the idea that if he studied enough, he could pick out the winning trades and let the losers go. In fact, those few trades he had taken had been losers. Time and money were slipping away. It costs money just to sit there day after day doing nothing.

John said he was learning by watching the market. I suggested that what he was learning was how not to trade. I suggested he start each day setting his intention to actually trade, and that he leave the screen as soon as he let the first trade go by. He agreed, but was unable to do that. He sat there watching, telling himself he was learning about the market. He had developed a comfortable spectator sport.

When fear is stronger than desire, fear dominates. John feared losing money, and he feared being wrong. Each time a signal came up, he imagined that if he took the trade, it would be a loser. Imagination is stronger than will power, and so he was unable - no matter how determined - to put the trade on.

Over the next three months, John began to trade. First, he mentally rehearsed taking all the trades. He shifted the belief that losing made him a loser and was wrong, to the belief that losing is a natural part of the game and that not taking all the trades is wrong. He shifted his imagination from losing to winning by asking himself whenever an entry signal came up, "What if this trade is a big winner?"

Most importantly, he learned to set a new intention when he began each day's trading. He shifted his intention away from losing or making money to following his system. He understood that the long-term consequences of following a winning strategy consistently was indeed wealth creation.

He developed what I call emotional inoculation through actual trading. At first he only took one trade a day, then two, then three, and finally all of them. Each time he took a trade, it became less significant and easier to do. Today he makes a nice living with his trading.

### Developing A Trading Psychology Plan

After reading the article/interview above - it occurred to me that we continue to discuss the importance of trading

AND planning; you can't trade without a plan that is both consistent with your personality and with a given trading methodology. The plan must then further define the components of the trading methodology in order to develop specific trading setups, as well as a way to manage the risk/reward of those setups.

The objective of the *trading method plan* is to develop a plan that includes your 'core' repetitive setups that you have established a positive expectancy, that you can recognize realtime AND that you have accepted the implications of in terms of related risk/reward. BUT this might not be enough - there still may be issues that are related to emotion AND fear that circumvent the implementation of the method plan.

Like a trading methodology plan being a key to making the transition from method to paper trading to realtime trading, making a trading psychology plan would be just as significant to making the transition from trader action/trader psychology to trading method/trader trading.

The objective of the *trading psychology plan* is to develop a plan to deal with the emotion/fear issues that either circumvent the method implementation OR keeps a trader from trading at all. Take the trader's actions and give an honest assessment/understanding of a given action, and then define a 'setup' for replacing the action. Consider the excerpt from the article AND then evaluate the actions as follows:

#### Trading Plan – Methodology

- 5 to 20 trades a day
- makes money on paper

#### Trader Actions

- didn't trade
- attempts to pick out the winning trades and let the losers go
- learning by watching the market

#### Psychology

- create excuse for not trading
- anticipate negative outcome
- fear/pain avoidance

#### Trading Plan – Psychology

- accept losing as part of trading
- accept possibility of winning
- replace focus of winning/losing with objective of following plan
- implement plan in steps instead of all at once

#### Trader Self Talk - Question/Answer

The plan itself will have to include a 'look in the mirror' AND an 'honest' assessment of what you see [don't break the mirror first]. You will have to ask tough questions AND the quality of those questions will be instrumental in getting from step to step. I liken this to some of the trading questions I receive AND my ability to then give a general answer OR a specific answer. Someone may ask should I go long when momentum turns green BUT with no further information about market conditions regarding continuation/congestion, direction/counter, or other related indicators - the best answer available is sometimes which is really no answer at all.

Relate this to any kind of problem solving and the asking/answering of questions - both to yourself, or to someone whom you are working with; HOW is anyone supposed to answer such general questions with more than a general answer at best - let alone give an answer that will aid in developing a workable solution/plan - specific questions that will ALLOW an answer with pertinent content is extremely necessary. Regarding the 'look in the mirror' questions - equally important will be to ask questions that are of a neutral non-judgmental nature in order to allow a constructive usable answer. So consider a trader asking questions like: WHY can't I trade - WHY am I such a failure - WHAT is wrong with me - etc. Not only do I view these as 'unanswerable' questions - I also see them as destructive type questions that will push you into [OR further into] an emotional snowball that further intensifies the problems that you are supposedly trying to construct a plan to solve as you give answers like: BECAUSE I am a loser - BECAUSE I am too stupid - etc.

I see no way that a trader could ever expect to make that transition from emotion to method when they are asking questions like this OR letting themselves think like this. Your questions will direct your further thinking AND thought processing as you answer AND certainly explains why emotional issues are so prevalent in trading - as the trader further creates AND worsens the emotions that are their primary problem[s] to begin with.

Negative self talk not only prevents us from solving problems BUT depending on how extensive this becomes - what is referred to as cognitive distortion - it may even prevent the person from even acknowledging that there is a possible solution. A continual series of self talk including I can't do it instead of WHAT can I do - both disqualifies that any positive experiences have ever existed to draw from AND directs thinking away from constructive actions. Asking the neutral questions - the WHAT can I/HOW can I - can lead to actionable answers that acknowledges the potential for a positive solution.

#### Emotions Are Part Of Life

I do not think that emotions are good/bad OR should be viewed that way - they exist in everyone as a part of life. What becomes important is your understanding of YOUR emotions - what they are AND how they further effect the way you act - again without judgment AND with the objective of controlling the emotion instead of having it control you AND in this specific case of trading - keeping the emotion from circumventing your trading plan.

#### Trading Psychology Plan

Like any kind of planning/plan making - analogizing the process to things that you have done before AND can relate to from experience will be very useful. In this case it would be the development of your trading methodology plan AND making it personal to you. Emotion AND fear have some general types BUT which ones most impact you will be extremely individual AND the trader must have a plan for both identifying what is most impacting them AND then have a plan for dealing with the outcome the emotion brings - I don't think the objective is to eliminate the emotion. I would like to analogize to the trading method plan AND trading indicators - to a psychology indicator attempting to measure when you are going from a neutral trading psychology to over-emotional AND thus leave your trading method plan for the actions that the specific emotions lead to.

The steps to this kind of plan were outlined/discussed in the training session - I believe that the absolute key to this plan will be defining your actions brought on by emotion/fear accurately AND without further judgment. From here, you have enabled a base for controlling the emotion by replacing it with evaluation AND doing so as a conscious act where the objective becomes overcoming the impact emotional responses have on trading.

As mentioned, I don't think that eliminating emotions is the objective - NOR do I even think it's necessarily a good thing. For instance IF I am confused AND that causes me an emotional response of hesitation - I actually want to

see/feel that emotion - it becomes a warning to me that I should wait AND try to find more clarity to the chart/market - asking myself what needs to happen for me to take the next trade.

Shift The Focus Of What The Emotion Represents

But WHAT IF the emotion is the norm instead of a warning of trading conditions.

- make a list of your emotions/fears AND rank the extreme of the emotion
- determine whether the emotion has reached an unwarranted extreme
- shift the focus of what the emotion represents

Consider: what is loss - a basic characteristic/function of trading that must be accepted, or is loss equivalent to trader failure and a further comment on the trader's intelligence and worth?

Consider: you find that being stopped out on the entry bar of a trade elicits an emotional extreme. As a result, you further feel that IF you can be stopped out that quickly on the entry bar of a trade THEN you are too stupid to trade AND might as well quit trading altogether; now try to enter the next trade setup.

Is this emotional reaction extreme, and the resulting self talk, warranted or a logical conclusion to being stopped out on the entry bar of a trade? You will not be able to answer this question, or keep it from reaching the extreme that it reaches, without shifting the focus of what the specific action represents - ask yourself:

1. was the trade a plan trade AND IF so - how often will that same setup/trade go on to a partial profit - isn't losing part of trading that is to be expected regardless that sometimes it may happen immediately - was there anything i can consistently see in my entry timing that could have made a difference.
2. was the trade a non-plan trade AND IF so - what did i miss in the setup identification.
3. did you just make a mistake AND IF so - shift the focus from the emotional extreme response to NOT being perfect - take your stop AND go on to the next setup.

Trading Anxiety

- fear trading so avoid trade
- force trade to overcome emotion
- diminished perception/lack of clarity when anxious
- immediately exit trades to reduce anxiety
- worry about things that are not verifiable - distortions

Distortion

- are you FINE - freaked out-insecure-neurotic-emotional
- all or none -vs- incremental changes and adjustments
- perfectionism -vs- 70% objective
- trading vocabulary

- mistakes are permanent conditions that will always continue -vs- temporary and natural

Consider: the perfectionist refuses to find the positive in what they do, they give themselves credit for nothing they do, they always should have done better – the corollary would then be the non-acceptance of loss which is one of the most important psychological components to being a trade. It's impossible to be perfect.

Consider: change your vocabulary and change your attitude, this may be even be a physical body chemistry change. Regardless, you did not get 'killed' when you lose 6 er2 ticks – there was not a 'huge' retrace against your trade when the er2 retraces 6 ticks.

- irrational ideas and beliefs lead to false assumptions – and this leads to avoidance
- overestimating the potential for negative consequences, thus leading to increase anxiety and causing fear – then this anxiety leads to avoidance to eliminate fear the fear that the trading plan is 'supposed' to manage.

Consider: mistakes are not permanent by definition – they have a 'norm' and 'odds' to reoccurrence. Mistakes are external – they are not internal and a personal part of the trader.

#### Accurate Self Monitoring/Assessment

- accurate assessment – refute distortions and remain neutral
- accurate measurement of progress using small attainable/realistic goals
- don't overwhelm yourself or expect immediate large scale changes – like perfectionism this is unrealistic and not possible
- have a way to recognize your distortions

Consider: make a check list of distortions or specific anxieties/negative things that want to avoid, and when they occur confront the problem. Don't shut down, and ignore the issues or hide from them, as if they don't exist or will go away by themselves.

Consider: what would you tell somebody else to do, who mentioned these same problems to you and asked for your help?

Consider: make a chart that lists the specific occurrence that 'triggers' a distortion – evaluate whether it's indeed distorted – accurately assess the occurrence. This is very necessary so that you don't continue to 'anchor' the occurrence to the distortion – so that the occurrence continues to lead to the distortion and the related response.

You have a great trading method and trading plan. You have profitably paper traded, and you now start trading real money AND everything falls apart, your method and plan no longer work. Everything you do is wrong, and you continually lose money - you come to the point where you can't even trade any more. HOWEVER - do you have a trading psychology plan?

Copyright © 2005 Tactical Trading, LLC. All rights reserved.  
Reproduction in whole or in part without permission is prohibited.

All links and articles are being provided for informational and/or educational use only - they may contain inaccurate, untimely, or incomplete information. You agree that the use of any links from this site, and the information available at such links, is being done at your own risk.

Copyright © 2004-2006 The Traders Resource All Rights Reserved