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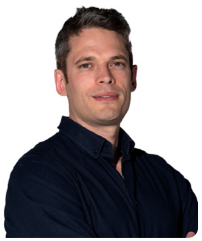
The Psychological Struggle: A Trading Mindset

An overview of the psychological struggle many professional traders experience and how they can circumvent common pitfalls and save time.



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key points

- Fear is one of the primary factors behind failure to achieve consistent success.
- It is impossible to eliminate emotion from trading, though one can learn to control their response to the emotional challenges from engaging with the financial markets.
- A trading strategy that always generates winning trades is impossible.
- On average, over a sample of trades, one can expect 70% of the trades to be winners.
- Fear in trading can be reduced through a technique known as systematic desensitisation.

My first oversight was believing that trading was straightforward. Markets go up, and markets go down; how hard could it be? This is where most begin their trading journey, invariably ending in frustration and eye-opening disappointment.

I intend for this to be a straightforward post, shedding light on my journey through the lens of a trader with 15 years of market experience. The focus will be on the psychological struggle many professional traders experience; hopefully, this will help some readers circumvent common pitfalls and save time.

Fear

Fear is so powerful it can make us hesitant to trade and drive us to make poor decisions. Fear can override the ability to think rationally, and we must be able to think rationally and objectively to trade successfully. Throughout my time in the markets, I learnt that fear is one of the primary factors behind failure to achieve consistent success, whether you trade or invest in foreign exchange markets, stock markets, bonds, commodities, etc. On a physical level, I feel we almost enter a *fight or flight* mode when we trade. Why this occurs is difficult for me to understand. All I can put it down to is our brain thinking that the possibility of a losing trade is a *threatening* situation.

You often hear (and read) traders and investors recommending to 'trade without emotion'. I understand why they propose doing this. However, irrespective of whether you base your trading decisions on a discretionary, partially discretionary or non-discretionary approach, there will always be an element of psychological influence. It is impossible to eliminate emotion from our trading, though we can learn to *control* our *response* to the emotional challenges from engaging with the financial markets.

The point is that while removing fear is impossible, learning to *control* fear is possible and is a *learned skill*. Those who have attained a level of consistency in their trading and fall into the bucket of consistent winners have, among other things, learned to understand, control and accept fear.

I never acknowledged the need to focus on my trading mindset until later in my career, which was a mistake. I believed if I had a strategy that had a positive expectancy, that was all I needed. A strategy with positive expectancy informs the trader how much they can expect to generate from each trade in the long run.

Expectancy = (Average Gain * Winning Percentage) – (Average Loss * Losing Percentage)

To be clear, you need a strategy that delivers positive expectancy, as your account will eventually be emptied over the long run without one. But you do not need a trading strategy that always generates winning trades; that is impossible. Most professional traders I know only win 50-60% of the time (some much less), though they still manage to generate a consistent return through favourable risk/reward: they win more on the winning trades than they lose on losing trades.

You will be wrong, and you will have losing trades. The quicker this is acknowledged and accepted, the more straightforward trading the financial markets will be. This is something professional traders accept and is key to achieving consistent success. Consistently successful trading limits losses and employs optimal trade management on winning trades.

How Do We Control Fear When Trading?

As far as I am aware, there is no easy way to reduce the fear of trading and risk, and this is why I believe many successful traders can take so long to reach a level of consistency.

The only way I have found to help reduce fear in trading (that made sense to me) is through a technique known as *systematic desensitisation*. While I am by no means an expert regarding this method, I approached this technique in three steps:

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1. Learning how to control my breathing to regulate the nervous system: This helped me lower my stress levels when in a trade. I largely used *numbered breathing* exercises, allowing me to be more present in the trade. This was difficult for me initially.
2. Listing my fears relating to trading: My fears concerning trading are simple: the fear of failure, the fear of being wrong and the fear of losing money. These are common fears among traders as well as investors.
3. Gradual exposure to these fears: To seek measured exposure to the risks and fears of trading, I began with a demo account. I also used the FX tester to backtest strategies. This provided me with statistics that elevated my confidence to trade live funds.

I then began with a small trading account. I cannot emphasise this point enough; it is crucial to begin small, as emotional influences can affect your decision-making process when employing oversized trading accounts and turn a winning system into a losing one. I started with a small account and risked 1%; remember, the idea was to acclimatise to the risk and fear associated with trading gradually. If I grew my account over the next quarter, I would feel comfortable increasing my account size incrementally and, consequently, my risk.

How much should you increase your account by? That will be down to the individual trader. We are all unique and have different goals. The point is to continually increase your account size as you become more familiar with the fears you listed in step two, helping to make trading a far less frustrating task.

I have found this is the best way to not only increase confidence but also help reduce the fear of trading.

No One Knows What Will Happen on a Trade-By-Trade Basis

I have met a lot of brilliant traders, and all of them have reaffirmed this point: no one knows what will happen on a trade-by-trade basis. This is a crucial point many traders merely pay lip service to and do not truly accept that they have no control over the next trade's outcome. It does not matter whether your system has a winning percentage of 70%. It is impossible to know whether the next trade will be a winner or a loser. But, on average, over a sample of trades, we can expect 70% of the trades to be winners, but it's impossible to know which ones will be winners in that sample.

As independent traders, we can only control four things:

- Entry and Exit
- Risk Management
- Mental State of Mind
- Trading Plan

It Is Not About Being Right or Wrong

Alongside understanding that we have no control over the next trade, we must understand and accept that while in a trade, it is not about being right or wrong. It is ok to be wrong in trading. In fact, we will be wrong, and we will be wrong a lot, and the sooner we accept this, as I noted above, the more straightforward trading will become.

We already know we cannot put any emphasis on one individual trade, so if we know that, and we know that risk is controlled, then why are we concerned with winning and losing if we understand through our back test and forward test (those statistics I mentioned at the beginning of the article) that we have a strategy with positive expectancy?

Let's think about this. We spent the time backtesting and likely forward testing on a demo account to validate our trading strategy, and we have the statistics to back this up. And let's say that in our back test, our maximum drawdown consisted of eight consecutive losses, so why would we panic after two or three consecutive losses when trading a live account, as this is not new information? If you put the work in with the backtesting, it will make trading with live funds a far simpler and less stressful venture.