

"Sharpening Your Trading Skills:" The Psychology of Trading

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In past articles, I have told my readers about the quality trading seminars I have attended through the years and how beneficial they are to anyone seeking knowledge and wisdom on the road to becoming a successful trader. The other night I was browsing through the workbook from a Technical Analysis Group (TAG) conference I attended in 1996. These TAG workbooks are packed with valuable information presented by all the speakers (usually 20 or more) at each conference. As I was thumbing through this particular workbook, there was a common theme espoused by the majority of presenters at the conference: In order to succeed at trading, it's not only important to strive to learn more about markets and trading tools, but it's also very important for a trader to know himself or herself. This is part of the all-important--but sometimes overlooked--aspect of "trading psychology."

I will admit that when I first got into this fascinating business, I was skeptical of the whole "trader psychology" thing. My main concern at that time was learning as much about markets and technical analysis as I could--and my trading mentality or psychology would take care of itself. However, the more I learned about the markets and about trading, the more I realized human nature and psychology play huge roles in both.

The following are some valuable "nuggets" regarding trading psychology that I pulled out of the TAG workbook. It's my hope that one or more of these "nuggets" will help you better understand your own trading psychology and the importance of psychology in trading markets.

- Remember that becoming a profitable trader is a journey, not just a destination. The perfect trader does not yet exist. Try to become a better trader each day and enjoy the progress you make. Concentrate on learning the craft of technical analysis and on improving your trading skills, rather than focusing solely on the amount of profit or losses in your trading.
- Congratulate yourself and feel good about a trade when you have done what you were supposed to do, according to your trading plan--regardless of the profit or loss on the trade.
- Don't get overly excited about the winning trades or too depressed about the losing trades. Try to maintain an even keel and a professional outlook regarding your trading.
- Do not expect certainty in a trade. You are looking for a preponderance of evidence, not proof beyond the shadow of a doubt.
- The pain of standing aside and missing a good trade that your method told you to take is much worse than the pain of losing on a trade that you entered and exited properly and according to your trading plan.
- Your own life experiences shape how you think about trading. If your first experience with trading was a negative one, the odds are high that you will not trade in that particular market again for a long time--and maybe never. The psychological impact of loss and defeat can be much greater and last much longer than the effects of physical pain. If you were not defeated psychologically by a negative trading experience, then the loss does not have such a negative and lasting impact.

- Education plays an important role in shaping the way traders think about trading. A formal business education can give you an edge in understanding the economy and the market in general--but it is no guarantee of success in trading. Most of the information you learned in a formal college setting will not give you the specific knowledge necessary to be a successful trader. To succeed in trading, you must learn to perceive opportunity where most others see none--and you must seek out the information which gives you the knowledge necessary for success.
- Your ego and winning can make you broke. Winning can create powerful emotions that distort reality. The more you win, the better you feel, and your ego takes over. The joy of winning is what gamblers seek. A gambler will lose as many times as necessary just for the thrill of winning once.
- Always remember this: You are the sole person responsible for winning or losing in trading. Don't blame the market or your broker. Losses are an opportunity to focus on whatever problem occurred during the trade. Don't get caught up in personal denial.
- A successful trader quantifies, analyzes and truly understands and accepts risk. Emotional and psychological acceptance of risk is what determines your mental state in each trade. Individual risk tolerance and preferred trading timeframe make each trader unique. Select a trading methodology that reflects your preferred timeframe and risk tolerance.
- The market is not physical. It's an amalgamation of the mindset of all trading participants. The daily tug-of-war between the bulls and the bears reveals what they are thinking on a daily basis. Make sure to look at the market's close in relation to the session high and low. (Note: Many times in my Daily Market Updates you'll notice that I say the market closed near the session high or near the session low. I do this because it's one determinant of the near-term strength of the market.
- Never buy just because the price is low, or sell just because the price is high. Never average a losing trade. Don't become impatient with the market. Always have a good reason for initiating every trade. Remember, the markets are always right.
- Traders need to listen to the market. To listen effectively to the market, traders need to know and pay attention to their trading methods, but also pay just as much attention to themselves as they pay to their charts and the market. The trader's challenge is this: Learn who you actually are, and then consistently and consciously develop the qualities that allow you to trade well.
- As traders, the more we can detach ourselves from the emotions of hope, greed and fear, the better our chances for trading success. Why are there hundreds of good technical analysts but few good traders? Because they need to spend more time on their personal psychology than their analytical methodology.
- "If I had eight hours to chop down a tree, I'd spend six hours sharpening my axe."
-Abraham Lincoln
I like this maxim, because it is similar to trading: Research and learning are very important. Preparation for trading takes much longer than executing and watching the trade.
- The market has far more patience than the majority of traders. There is an old saying that the market will do whatever it takes to drive the largest amount of traders crazy. Trends can persist as long as there are traders fighting them. Don't fight the tape.