

THE ESSENTIALS OF WINNING PSYCHOLOGY

by Ray Barros

It is my belief that successful trading is a function of:

- A written trading plan with an edge
- Effective Money Management and
- Winning Psychology

In this essay I shall:

1. Identify the essential element of winning psychology.
2. Identify the personal attributes required.
3. Show the belief structure necessary to achieve and maintain essential element.
4. Identify the blocks to winning psychology, and
5. Mention some tools I found useful in this context.

There are two concepts I should like to explore before beginning the article. The first has to do with the way I believe humans acquire knowledge.

There is an objective reality which humans perceive through the filters of their values, beliefs and rules. This perception can and usually distorts our sense of reality. The extent to which we reduce or eliminate the distortion is the extent to which we will be successful in life. This is especially true for traders.

The second idea I want to introduce is that of the evolution of a trader. For me the natural progression is:

1. The Rule Based Trader: "There is one rule: never break your rules"
2. The Subjective Trader: "There are two rules:
3. The first is never break your rules.
4. The second is know when to break the first".
5. The Intuitive Trader: "There are no rules. Whatever my intuition tells me is the right action on this trade is the correct action in the circumstances.

This belief accords with reality more often than not".

All types of traders can make money as long as they conform to the rules of that stage. e.g. a trader at the Rule Based Stage is more than likely to lose money in the long run if he breaks his rules. Finally, before I begin I should like to briefly explore what I consider the necessary empowering motivation to succeed.

Trading is success is simple to achieve but not easy. It is simple because the roadmap for success has been clearly laid out in all the three areas - written trading plan etc; it is not easy because following that roadmap is not easy.

What motivation is necessary to get us through the rough patches?

At some level we traders are attracted to this game because of the money we can earn. But, I have found that money alone is an insufficient motive. All good traders I know LOVE the game for itself. The fact that we get paid for it is merely a bonus. This love for the game is incorporated into the

vision we want to achieve as a result of our trading and that vision is the zing that gets us through the rough patches. It goes without saying that for successful traders, trading is fun.

I The Essential Element of Winning Psychology

At its core, winning psychology has as its base the "acceptance of the outcome of a trade".

By acceptance I mean the ability of being aware of an emotion without "buying into" its content; some may call this 'mindfulness'. e.g.

Contrast:

Imagine you have just entered a trade and the very next bar is a big range bar against your position:

"My God here I go again! Can't I do anything right! What will my wife say if I take yet another losing trade!"

Maybe I should move my stop? No I can't do that - the last time it cost me my bank! But what about the other day when I got stopped out only to have it go my way? This is just too hard!!!!" etc, etc.
With:

Imagine you have just entered a trade and the very next bar is a big range bar against your position:

"The market is approaching my stop. I feel uncomfortable with the price action and I can live with the discomfort".

The first trader may think he has accepted the outcome but in fact he has failed to do so at the emotional level; the second trader has accepted the outcome at all levels.

This idea of acceptance applies not only to losses but to profits as well. The trader that "accepts" an outcome realizes that on an individual trade basis a positive outcome on one trade does not translate into a future of unlimited profits.

At its core "acceptance" realizes that trading is based on probabilities, as such every trade is unique. In other words, the past does not equal the future. More on this in the section dealing with beliefs.

II Identify the Personal Attributes Required

If we are to acquire "Acceptance", then certain personal attributes are essential:

- Awareness - the ability to step outside ourselves and observe. The more effectively we can do this, the easier our progress to "Acceptance".
- Honesty - the ability to seek to perceive reality in spite of our filters.
- Courage - the willingness to bear the pain brought about by our awareness and honesty.
- Commitment - the willingness to do whatever is necessary to achieve our goals.

In the words of Chin-Ning Chu author of "Thick Face, Black Heart":

"Even though most people think they are trying to succeed, they are simply going through the motions. The last thing in the world they want is to get off the familiar treadmill and actually get somewhere".

We cannot succeed in our journey to "Acceptance" unless we acquire these attributes. To the extent that we have them is the extent to which we will experience fulfillment.

III The Belief Structure Necessary to Achieve and Maintain "Acceptance"

Ultimately to succeed, we, as traders, need to adopt two apparently contradictory beliefs:

"That the market is uncertain and unpredictable and that the market is relatively certain and predictable".

The resolution of this apparent conflict is found in the timeframes that we hold the beliefs. At the trade-by-trade level, what Mark Douglas, calls the micro level, we hold the first belief. Because the market can and will probably do anything, we seek first to protect our capital in the execution of our trading plan. In other words, we must always have an exit strategy.

At the level of a "large sample size" (the macro level), we hold the second belief. To the extent our trading plan has an edge, will be the extent to which the market will be predictable and certain. In short we accept that with trading we are dealing with probabilities and not certainties. It is of imperative importance we hold these beliefs not only at an intellectual level but also at every level of our being - especially the emotional level.

As a trading coach I have seen, time and again, lip service acceptance to the idea of probability; but when it comes to actually trading, the traders behave as if each and every trade must be a winner - they have a need for certainty. How else can we explain the popularity of services advertising 90% hit rates? If the ads were not drawing an adequate response, they would disappear.

Probability thinking leads to a host of other states and beliefs:

1. Because we know that we will succeed in the long run and because we know we will protect ourselves no matter what the market does, we acquire the state of "self trust" and the state of being "carefree". In turn these states allow us to remain....
2. Focused, confident and carefree when we are experiencing the inevitable prolonged drawdown.
3. Because at the micro level we know that the market is random, we will not allow euphoria to set in and lead us to reckless trades. Each trade will only be one in a series of probabilities.
4. We will view market information not as a source of pleasure/pain but merely as data providing us with opportunities.

This is not to say trading should not be fun; indeed not only should it be but for most traders it **MUST** be. However, the fun comes from the flawless execution of the rules appropriate to our stage of evolution and not from trade by trade results.

IV Identify the Blocks to Winning Psychology

The main enemy to "Acceptance" is Fear.

The universal fears are:

- The fear of being abandoned and
- The fear of losing control.

If we reflect for a moment, we'll see how the fear of being abandoned comes about. As young children, we are totally dependent on our parents. Very quickly we come to realize that if they ever abandon us, we shall be unable to care for ourselves. Most of us fail to confront this fear as we grow into adulthood. As a result we automatically deal with it by attempting to control our environment - the people, conditions and events that surround us.

This tendency to control may or may not be appropriate in other areas of life but as a strategy for trading the markets it is a bust. Most of us are incapable of influencing the market even for the shortest moment, let alone control it.

Mark Douglas's four fears are but an outgrowth of the two universal fears:

1. Fear of loss

2. Fear of being wrong
3. Fear of missing out
4. Fear of leaving money on the table.

These may be more familiar to the trader.

I first gained an insight into effects of fear some years ago. At that time, I was trading futures through Jackson Futures. The company provided a trading room and I met a quiet chap. He came in a few minutes after the US Bonds opened and left just after the close. Given that trading opened (Aussie time) 12:30 am and closed 5:00 am, this was no mean effort. One morning I noticed he looked very distressed and I struck up a conversation with him. He told me he had bet the farm shorting a strong bull market. As his red-rimmed eyes stared off in the distance he said:

"I don't know why I just didn't cut the position earlier; anyone would have seen the strength - why didn't I?"

I never saw him again.

That is the effect of fear - it drives out knowledge; it leads to myopia; it immobilizes us and leads to inaction.

The mirror image of fear is euphoria - the feeling that we can do no wrong. As much as fear, euphoria will ultimately lead to trading failure. Since trading is a game of probabilities, we will experience times when we can do no wrong. But these times will come to an end. The trader caught in the euphoric trance will not recognize this and taking one risk too many will eventually get caught in a heavy loss. If he is lucky, the loss will not be a catastrophic loss.

Fear and Euphoria can catch not only newbies but also the most experienced and successful trader. Witness the demise of (Trader) Vic Sperandeo. Vic started trading public funds in 1972 and for over 25 years had a very successful career. His view on trading can best be summarized by the passage below:

"I'm a market professional....and I am very good at what I do.... I never gamble more than I can afford to lose.... I think my unique strength is in my consistency.. I pride myself in my ability to successfully stay in the game..."

(Trader Vic - Methods of a Wall Street Master page ix)

This year Vic went bankrupt as a result of one trade.

Euphoria or Fear?

It doesn't matter. Whatever the reason, Vic lost a reputed US\$50 million and is now out of the game. Two other factors impact on our fear or euphoria:

* Our expectations. Rather than accept market information in its pure form, we impose our expectations. In turn these expectations impact on our fear and/or euphoria.

* Our own psychosis. Each of us grows into adulthood with our psychosis - what Stephen Wolinsky calls "trances". Thus many times our responses to market information are not a response to present information but to past events. In other words, we are not trading in the NOW or with PRESENT TENSE INFORMATION.

V Some Tools I Have Found Useful

To achieve "Acceptance", we need to manage "Fear and Euphoria". For me the decisive tool was learning strategies to be aware, acknowledge, and manage the twin emotions of fear and euphoria. This meant starting with small pains and slowly becoming comfortable with my feelings. When I first started trading successfully, I used discipline as my main weapon. But when I started fund

management in 1991, I found it inadequate. Dr George Lianos helped me discover the way of managing emotions - not eliminating, MANAGING. George taught me that a step-by-step approach was the best way for me. Learning to manage small fears, I slowly learnt to handle FEAR and EUPHORIA in my trading. I have developed a process based on the works of S. Wolinsky (Tao of Chaos) and C. Andreas (Core Transformation).

Other tools I have found useful are:

1. Meditation and/or mindfulness. These techniques taught me how to remain unruffled and centered during the hurly-burly of real-time trading. More than any other tool I use, they teach me that AWARENESS is everything. They are long-term tools.
2. The ideas and distinctions of Mark Douglas. Another long-term technique.
3. Neuro Linguistic (NLP) techniques. Useful for absorbing pain. A medium term technique.
4. Breathe work and Posture. Learning to breathe, stand and/or sit properly are effective short-term tools to remain calm in periods of stress.

VI SUMMARY

To succeed a trader must have a vision about where he is heading and must internalise that Winning Psychology rests on Acceptance of the trading outcome. This means managing Fear and Euphoria. To do this, we need to ACCEPT, with every fibre of our body the belief that at the micro level the market is uncertain and unpredictable and at the macro level is relatively certain and predictable.

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