The Three Vices of Trading

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The following is a short article for Woodie's CCI traders. It summarizes several of the psychological pitfalls that interfere with accurate pattern recognition. My hope is that CCI traders can focus on these three "vices" as mental preparation prior to entering the markets. One of the best ways of becoming an observer to your negative behavioral patterns—rather than a trader lost in those patterns—is to periodically take your emotional temperature. That means standing back and asking yourself: Am I falling prey to one of the vices below? Remember, observing and interrupting your patterns are the first steps in altering them! Your patterns lose control over you as you become better at not identifying with them. When you become an observer to your patterns, you are separating yourself from them. What great progress that is!

Vice Number One: PERFECTIONISM

Perfectionism is often the chief culprit when the pain of losing exceeds the pleasure of winning. Desperately trying to feel good about themselves, perfectionists set unrealistically high ideals. They think they will finally be OK if they just accomplish X. (For X, you could substitute many things, including looks, wealth, popularity, or achievement). Because X is an unattainable goal, perfectionists ironically use their ideals as a basis for self-criticism when their performance doesn't match up. After all, is achieving X will make me OK, then I must not be OK if I fail to achieve X. The emotional theme of the perfectionist is "*not good enough*". Perfectionists are driven to do more and more because they never feel competent, worthy, and loved as they are. Thus, even when there's a profit on a trade, perfectionists will look for the portion of the move that they did not participate in. If they caught most the move, they will reprove themselves for not trading a larger position. And when trades don't go well, perfectionists review all the reasons that shouldn't have made the trade, should have known better, etc. By focusing on the portion of their performance that doesn't match their ideals, perfectionists transform successes into defeats, losses into failures. They rationalize their perfectionism as a drive for achievement, but all they are accomplishing is an undercutting of their confidence.

Perfectionism shows up as negative self-talk and self-blaming. Emotionally, we recognize perfectionism from frustrated, angry feelings when trades don't work out as planned. "Beating myself up" is how many perfectionists describe their self-talk. The way to beat perfectionism is to make a concerted effort to talk to yourself the way you would talk to a good friend in a situation where things went wrong. Most people know how to treat others with respect, love, and dignity. They just haven't learned to do the same for themselves. If you would be more nurturing, understanding, and supportive of a friend than you are of yourself in the identical situation, then you know that you're not being your own best friend. If a trade doesn't work out, the constructive trader focuses on, “What can I learn from this?”—not “What’s wrong with me?”. In Woodie’s language, the best antidote to perfectionism is the ability to reassure yourself, “There will be better trades down the road.” The key is to not miss those better trades while you’re beating yourself up!

Vice Number Two: EGO

Everyone likes to win in the markets. It’s only natural to feel good when you’ve done your homework and end the day with a profit to reward your efforts. Ego involvement in trading, however, goes further than this. When the ego is involved, we write the market a blank check for our self-esteem. If trading is green, we feel good about ourselves; if we go into the red, we feel diminished. That places tremendous pressure on our trading over time. Not only do we have the burden and challenge of reading complex market patterns; now we also have a psychological gun pointed to our head ready to go off any time our pattern recognition fails us.

Most traders are aware of the dangers of trading with too much leverage. A trader accustomed to trading 2 lots, where each tick in the ES is worth $25, would feel overwhelmed jumping to 100 lots, where each tick now moves the account $1250. With the stakes raised to such a degree, the same trade would now no longer feel the same. It would be hard to let a position go against you by a point ($5000, instead of $100), and it would be difficult to let a profit run. When traders invest their feelings about themselves in their trading, they are operating with maximum *emotional* leverage. In the currency of self-esteem, they trade 100 lots. So much of their emotional account rides on each trade, that it inevitably affects decisions about cutting losses, letting profits run, and entering and exiting in a timely fashion. The successful trader wants their trades to work out; the ego-involved trader *needs* them to be profitable.

We know that ego threatens our trading when we find ourselves *needing* to trade just to win back some recently lost dollars; when we feel a desire to advertise our positions; and when we find ourselves riding an emotional roller coaster as profits wax and wane. Just as we can recognize traders’ perfectionism from anger/frustration, we recognize ego-involved traders from euphoria/depression. If trading has us truly depressed, we know that it’s not just our trading account that’s hurting. The antidote to ego-involved trading is to place our self-esteem eggs in many baskets: recreational interests; other work involvements; relationships; and our spiritual lives. Many times we pour our self-esteem into trading because those other facets of our lives are not properly developed. A balanced life makes for balanced trading. In the spirit of Woodie’s CCI Club, we can take some of the ego out of trading by learning from others, by becoming a candle that lights other candles, and by using a portion of market profits to help others make a wish that will come true. If your good feelings in life come from good relationships and worthy achievements, you won’t *need* the markets for your happiness. Market success can be the frosting on the cake of your successful life, rarely can it substitute to the cake itself.

Vice Number Three: OVERCONFIDENCE

It is common for traders to complain of a lack of confidence in their trading, but very often it is overconfidence that does them in. Overconfidence results from a lack of appreciation of the complexity of markets and an underestimation of the challenges of trading them successfully. In a sense, overconfident traders lack respect for the markets. They think that reading about a few setups or buying the newest software will prepare them to make money. Overconfident traders don't want to work their way up the trading ladder: they resist the idea that screen time is the best teacher. They also chafe at the idea of growing their account. Rather than start with one contract and wait until they're profitable before trading larger size, they want big positions—and profits—right away. Because they're so eager to make money—and so sure they can make it—overconfident traders generally trade impulsively. They won't wait for the setup to form; they'll jump the gun—and get whipsawed in the process. Instead of being patient and waiting for short-term patterns to align with longer-term patterns, they will take every trade, enriching their brokers in the process.

The hallmark of overconfident traders is that they think they are going to make something happen in the market, instead of patiently waiting to take what the market gives them. Spelling out profit goals for each day or week of trading is one manifestation of overconfidence. Humble traders know that markets expand and contract their volatility—sometimes the trade just isn't there. The overconfident trader, however, feels that he/she is bigger than the market. Indeed, overconfident traders will often take great pains to try to catch the tops of bull swings or the bottoms of corrections. As a result, they often fight the market trend—and can get run over in the process. If the emotional signs of perfectionism are anger/frustration and the emotional signs of ego involvement are elation/depression, then the emotional signs of overconfidence are impatience/impulsivity. *Overconfident traders overtrade*. They fear missing opportunities more than they fear losing money. The antidote to overconfidence is rule-based trading and the intensive rehearsal of trading rules. By making entries, exits, stops, and position sizing rule-governed and vigorously rehearsing trading rules during simulated trading (as well as in real time with small positions), traders can greatly reduce their impulsive trading. Very often this means training oneself to focus on (and rehearse) what-if scenarios of being wrong in the market, as well as forcing oneself to spell out the rationale, targets, and stops for all trades. By making trading a more self-conscious process, traders interpose thought between impulse and action, gaining greater control of their trading. When the trading room admonishes, "No boasting, just posting", it is encouraging restraint on overconfidence.

Summary

Clearly, the three vices are not completely independent of one another. There can be significant overlap for traders. For example, a trader might take a position out of overconfidence, then hold onto it out of ego-related stubbornness and pride. Whether the vice is perfectionism, ego, or overconfidence, the basic problem is the same: Making the trade about oneself, rather than about the markets. If you are thinking about yourself—how much you'll make or lose, how well or poorly you've done, how much you're a success or a loser, how much better you could have done—you can't be fully focused on the markets. It's not about you. It's about the setups and the ability to read them. And to read them, you must be one with them, immersed in them, so that you *feel* them, not just observe them. You can't feel the markets *and* become lost in feelings of anger, frustration, elation, guilt, depression, impatience, or impulsive need. The greatest vice in trading is to take it personally, to become so focused on the outcome of trading that you lose sight of the process. If you are fulfilled outside of trading, your other needs will not infiltrate your decision-making and sabotage your entries, exits, and money management. If you build yourself physically, socially, spiritually, and professionally, you will find that the markets won't need to bear the burden of carrying your identity. At that point, you'll be able to say (in your best Woodie voice):

We Don't Need No Stinkin' Vices!

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