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TRADING INSIGHTS

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Trading Psychology

Learn to Become a Disciplined Trader

Why do the majority of traders fail?

If I were allowed to give only one answer, my answer would be LACK OF DISCIPLINE. Becoming a successful trader is something that all traders aspire to, yet only a few ever achieve. Most experienced traders will tell you that staying disciplined is often times the single factor that separates the winners from the losers; not trading methods, chart interpretation, proprietary indicators or research, just discipline.

"Becoming a successful trader, requires absolute discipline"

So what does it mean to be disciplined?

It means waiting for a trade setup that fits perfectly into your trading plan.

- Staying calm under pressure
- No fear
- No greed
- No emotions

It means exiting the trade at the right price, not the right time, win or lose. On the surface, it sounds easy, but to achieve this quality of decision-making can take years of dedication. The problem is most low to mid-level retail traders never make it far enough to realize the importance of trading discipline. They get just far enough to lose most of their trading capital and then give up, never knowing that they may have been a few steps away from finally finding success.

Not only is trading discipline one of the most important qualities of a trader, it is also one of the most neglected disciplines. So why do most traders neglect it? To properly answer this question, we need to dissect human behavior and look at *why* traders do the things they do. In this article, we will discuss why trading discipline is so difficult to master and suggest some immediate steps you can take to improve your chances of staying disciplined and finding success in the stock market.

Rule #1: Set Up Trading Rules

We Are Only Human

As human beings, we have a natural desire to feel comfortable. This can be witnessed in everything we do, from our need to spend money, to our love for comfort foods. The same needs apply to our emotional tendencies as a trader. If a trader experiences a losing trade due to deviating from his trading plan, instead of acknowledging the trade as a loss he should have never experienced, he may justify it by blaming it on bad news that came out during the trade. This trader just committed two of the most common mistakes in trading. He not only violated his trading rules, but he also sabotaged all effort that went into creating positive trading habits up to this point.

"Generate your own set of trading rules that fit your trading plan and follow them strictly – no exceptions"

Before we go any further, I would like to make a very important distinction. There is a huge difference between knowing that trading discipline is important and putting that knowledge to work. Most struggling traders will be quick to tell you that they know discipline is important, but they lack the fortitude required to stay disciplined in the face of the unknown. This unknown in the market triggers two very common human emotions that can be detrimental to a trader, if not properly managed.

BUY ON GREED – SELL ON FEAR

Fear is a Trader's Worst Enemy

Understanding fear and its effects on trading discipline is critical to finding success as a trader. When a trader is in a losing position that continues to grow larger it becomes all too easy for fear to set in. When this happens, it is essential that the trader take a deep breath and unemotionally reassess the situation. Always remember that the stock market does not cater to emotions, so any fear that creeps in is 100% self-inflicted and lives only in our minds.

"The stock market does not cater to emotions"

Pigs Get Slaughtered

Greed is the other emotion that can be a trader's worst enemy. Many traders develop a habit of hanging on to a winning position too long, which often leads to a break-even trade, or worse, a loss. This habit is the byproduct of greed, and the sooner a trader recognizes this and corrects it the better off he will be. Like everything else with trading, recognizing and controlling greed is not easy, but it can be done. Similar to controlling fear, a trader can control greed by removing emotions from the market. One of the best ways to do this is to constantly remind yourself to trade the market and not your account balance. In other words, stay in a trade because your analysis tells you price has more room to move, not because you hope your account balance has more room to move.

"Trade the Market and not your account balance"

Trading is the ultimate psychological test. It will test your nerves on every level and it is completely up to you to be aware of your emotions at all times and learn to control them. So how do you do all of this? Here are a few steps to get you on your way: something that you do at the onset. As a trader, you need to have a solid method in place so that your actions are almost mechanical.

In addition to writing down the market's movements and you emotions, be sure to capture your trade data. You will want a record of entry price, number of shares, reason for the trade, etc. This will help keep you honest and prevent you from deviating from your trading plan.

Plan Your Trade

This goes hand in hand with developing a trading method. When you plan a trade, you are actually analyzing one specific trade and identifying areas of potential support, resistance, etc. Your analysis should then be compared to your defined set of entry rules as outlined by your trading method. If everything checks out, it becomes time to define your trading risk.

Limit Your Risk

Perhaps one of the most misunderstood keys to finding trading success is that of defining trading risk. The money you decide to risk on any one trade should be an amount you are comfortable losing. Risking more than you are comfortable losing is the fastest way to emotional trading and losing sight of becoming a disciplined trader.

"Clearly define your trading risk - Only loose what you are comfortable with"

Develop a Trading Method

Developing a trading method should be. Knowing when to get in and out of a trade must be well defined. This will not only help keep your emotions in check but will also provide consistency so you can better measure your progress. The stock market is a volatile place, so having a game plan is essential.

It is not enough to create and maintain a trading method in your mind; this is too easily broken. It is essential that the trading method, including all the rules to enter and exit a trade, should be written down somewhere. Once written down, be sure to keep these rules in plain sight when you are trading. Keep the entries and exit rules on a white board on the wall behind your trading station. Although you may know these rules by heart, read them again before every trade. This will help keep you disciplined on each trade.

"Write down your trading rules and follow them strictly – Keep a trading journal"

Paper Trade

Before you put your hard-earned money on the line, you will want to get a feel for the market and get comfortable with your broker's trading platform. Each broker is different and his or her trading platforms are equally different, therefore it is a good idea to open a paper trading (AKA demo account) to become familiar with the platform.

Another more obvious reason to paper trade is to become comfortable with your trading method, using your journal (discussed below) and of course practicing staying disciplined. Be sure to treat the demo account as if it is your hard-earned money and the transition to a real account will be that much easier.

Keep a Trading Journal

This method is tried and true to keeping your emotions in check. Write down everything before, during and after a trade. Capture how you are feeling as soon as you sit down at your trading station market. Is it trending up, down or chopping sideways. Also be sure to capture how you feel during the trade, are you hopeful, fearful, greedy, etc.? These are notes that will help you analyze your emotional behavior later. Do this for a few weeks and it quickly will become part of your routine, document the movement of the stock.

Be Patient

Mastering this skill becomes much easier when you create a trading method and stick to it. Often times the only difference between a losing trade and a profitable trade is patience and knowing when to let your trading method pull its weight. By being patient and only taking those trades that meet your entry rules, not only will you become more profitable, you will also find it much easier to measure your progress as a trader.

"The difference between a winning and a losing trade is PATIENCE"

Adapt to the Market

This may seem contradictory to developing a trading method and following a strict set of rules. Adapting to the stock market does not mean forget all rules and go with your gut feeling, it simply means evaluate the market's movement objectively and adopt accordingly. One way to do this is to trade from a longer period, such as the daily chart. Although not as exciting as the intraday charts, a slower moving chart gives you time to properly evaluate the market. This of course only applies if you are having a hard time with the shorter periods.

Bottom Line

Just like learning technical and fundamental analysis, becoming a disciplined trader takes practice and is a never-ending process. Implement the steps discussed here and do not hesitate to take a few minutes out of your trading time to objectively evaluate your feelings, you will be glad you did.

Good luck and happy trading!

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