A little Q & A

Your Quiz

Questions with Answers

10 Key Questions on Trading Discipline

THE Disciplined Trader
The Psychology of Profits

The following questions will conjure up different visions for each person. The idea is to relate to certain trading experiences and what actually happened in such situations-not what sounds like the best answer. Moreover, if a described situation has not yet been experienced, try to make an honest appraisal of how you would act. Again, not what sounds correct but how you think you would actually correct. Remember, being a successful trader requires continuous and almost brutal self-appraisal.

There are no “perfectly disciplined” traders. But there are many traders who come close. This quiz is meant to help you assess where you are in your quest to be The Disciplined Trader and help you to identify areas that you may want to improve upon… because the way to maximize your potential as a trader is BE The Disciplined Trader, and adhere to your tested trading plan without hesitation.

The following are the ten questions and answers.

1. You felt it in the pit of your stomach. Just by the way the volume jumped up, you could sense the fear as if it were right in the same room with you. Should you bail out of your position or wait to be stopped out? “If it doesn’t feel right then it’s time to get out,” you hear a small voice in the back of your head say. You act quickly and close out all of today’s positions. “Better safe than sorry,” you mutter; your hands still trembling. Has this ever happened to you?

(1) Too often (2) Sometimes (3) Just once in a while (4) Never

Answer: If you want to become a successful trader, this scenario is one that must be overcome and controlled emotionally. You see, fear and greed are always present and a trader can’t let themselves be swayed by emotions. “Listen to your heart” may be valid for some things, but not trading. A trader must be patient-even when things seem to be speeding up and going out of control.

If your plan calls for certain stops to be set, then you need to learn to have confidence in them. In other words, once a position has been taken, stick to the plan. How many times will you see a moment of panic followed by a deluge of buying or selling in the opposite direction? And this is usually followed by your fellow traders shaking their whipsawed heads. Be patient and learn to trust your system. Besides, if you have done your home-work on the trade, you should have hedged yourself against a catastrophic move. You will always do that, right?

2. When things get tough, it’s good to be able to shut the world out and concentrate on your trading activities. Focusing on your trading helps to block out some of those pesky domestic problems. Some mornings, however, you feel a little out of sorts and need some extra self-discipline to get started. How often is this the case for you?

(1) Too often (2) Sometimes (3) Just once in a while (4) Never

Answer: Even though traders are taught to trade as mechanically as possible, there are times when being human can demand attention - on both conscious and subconscious levels. Denial, emotional stress and other aspects of living can have a subtle influence on how we make decisions. We may tell ourselves that we are strong enough to “play through the pain” but a wise trader understands the need to be free from distractions, even those we suspect might or might not be there at all.

One of the more important advantages of developing the “Zen of trading” is getting in touch with who you REALLY are and that includes your weaknesses. For example, if you know certain situations upset you, even though you may not feel it, the wise trader will push back from the table, stand up and stretch, and decide that today might be a good day to play some golf or just read a book. Tomorrow is another day and another opportunity to trade. No need to push things. Keeping complete focus on your trading activities requires you also have an honest focus on yourself.

3. It looks like a fairly compelling trade. All your technical indicators that you use in your trading plan are in the proper places, but not too convincingly. You aren’t sure if there is a better trade - one with more obvious signals. You decide to pull up a new potential trade on your screen and everything looks good. Too good. You look up the company fundamentals (if you trade stocks, or a cross-currency, if you trade Forex, etc.) but they are not very convincing. In fact, you don’t like the industry (or the look of the complimentary currency, etc.). But the technical signals are right where you want them to be. You’re not sure what to do. You decide NOT to take a position in either trade. Within hours, the trades you refused to take have made big moves. This happens:

(1) Too often (2) Sometimes (3) Just once in a while (4) Never

Answer: During the development of your trading plan, you worked out a specific set of strategies and indicators to use when filtering out potential trades. If you don’t have enough confidence to trust in your system, then you probably need to do more work on it or at least identify what would make you not take a position if all other factors were favorable. Indeed, not pulling the trigger on a trade that meets your systems criteria means you have a weak spot in your trading plan.

If you are a new trader and find that you have suddenly become timid, perhaps you need to examine your current state of mind. Have you recently suffered a series of losses and have lost your confidence? Have you drawn down your account close to your drawdown limit? Is there anything else that might be bothering you? Maybe it's a good time to stop trading for awhile and re-think the reasons why you hesitate to pull the trigger, if all the signals are there.

4. This would be the fourth loss in a row. If you had a tail, it would be firmly between your legs. You intellectually understand that a run of bad luck (statistical anomaly) can happen but you still feel a little shaken. You do a quick analysis in your mind to review recent results. Is it just the quirks of probability or is something wrong with me or my system you wonder? You know that once there is some doubt, things can begin to unravel. There it is again, more negative thinking. Does this happen...

(1) Too often (2) Sometimes (3) Just once in a while (4) Never

Answer: First, you probably check your drawdown status. Then, you might decide that it would be a good time to review how you are using your system. Have you been making small adjustments to how you implement your trading system? Is there anything different about how you are going about your analysis? If not, maybe it's a good time to review the longer term trend of your win: loss ratio. If you see that there are no obvious flaws in your system or how you are implementing it, you must stay the course. If you still feel uneasy, you need to step back from trading and try to identify why you feel the way you do. Maybe continue trading, but switch to paper trading only. Once the win: loss becomes more normal, then and only then, resume your normal trading activities.

The more experience you have with your system, the more you will learn to trust it and use your guidelines to trade methodically. Let the results determine how well you are doing and have clear guidelines as to when you put on the brakes. Until that time comes, stick with your system and the way it is meant to be used.

5. For whatever reason, you suspect your current pattern of losing trades may be signaling a flaw in your trading system…or in you. So, how do you go about determining what, if anything needs to be adjusted or fixed? Where do you turn for the answers or do you just press on and let things unfold? These questions arise...

(1) Too often (2) Sometimes (3) Just once in a while (4) Never

Answer: Learning to be objective in the recording and analysis of our trading activities is A MUST if we want to become a successful trader. By our very nature, we tend to protect ourselves from criticism and put forth our best image…even for our own consumption. Learning to chronicle an objective performance and do an honest self-evaluation is the quickest way to learn from our mistakes and triumphs. We can be our own harshest critic and that is a good thing, if we keep ego from distorting the "truth".

Trading is a solitary activity and needs an objective point of view, if that is even possible. By becoming our own objective critic, learning can be an ongoing work-in progress. Sitting down and writing is a well known and widely practiced means for self-evaluation and behavior modification. Our personalities and habits are not set in concrete. They are what we make them to be.

Journaling is the history book on our trading activities and is the most powerful diagnostic tool we as traders can have. It must become an integral part of our trading procedures and a trade should not be considered complete until it has been fully analyzed and written down. Indeed, the very act of taking the time to analyze each trade is an essential key to becoming a successful and disciplined trader.

6. Your trading account has been growing nicely but what do you do with the capital gains? Do you take them off the table and use the gains for a special trip or to purchase that special toy? Do you take on more trades and hope for that exponential account growth curve? Do you move it off into a more conservative investment? Or, on the other hand, what do you do if your trading account starts to take some hits. Do you start making more trades and diversifying your risk or do you start to make larger trades in hopes of recouping losses? These questions go unanswered...

(1) Too often (2) Sometimes (3) Just once in a while (4) Never

Answer: One of the most important parts to trading is risk management. And perhaps the most important aspect of risk control is found in the subject of money management.

Money management is mainly composed of two important strategies. First, is the drawdown limits placed on the trading account drawdown limits are set to make sure that the trader hits a limit switch before losing too much trading capital and getting too far behind the ability to recoup losses. Usually, a drawdown limit of around 30% of the total account balance will help preserve enough capital to help the trader stay in the game before putting too much trading capital at risk. Secondly, money management also consists of establishing a maximum trading limit. Typically, that is around 1 to 2% of the trading balance on any trade.

A key aspect of being a successful trader is the ability to stay in the game and let probabilities work in a trader's favor. Money management not only provides important safety stops but also it helps establish a psychological comfort zone where the loss of capital will not make a significant impact on the trader’s well being. This helps traders to tone down the emotion of losing money.

7. Several months ago, you read an article on free cash flow as an important fundamental indicator for a company. It makes sense that sales numbers and profits are all subject to manipulation so you decided to start incorporating a measure of free cash flow into your decision making matrix. (If you trade currencies, maybe you read an article about how one country's currency affects another's currency, and now consider that relationship in your trading). Then, you heard it somewhere that candlesticks are better gauges of sentiment that RSI. So, you started using candlesticks as a surrogate for RSI. Today, you saw a piece on Bloomberg about hedging with Gold. It sounded good, so you decided to try it out. You find yourself considering alternative strategies...

(1) Very often (2) Sometimes (3) Just once in a while (4) Never

Answer: Trading is based upon the premise that using a disciplined strategy based on specific parameters acts like a filter and if applied the same way over many trades, a probability pattern can be developed with a relatively high degree of confidence. As a mathematician once put it: “the independent variable is the particular investment and the dependent variable will be the result of your trading function.” Plug and chug…that’s the Holy Grail. If a trader does not have a well defined trading plan, a plan that is executed in the same way each trade, developing a trading function is impossible and any win: loss ratio developed will be meaningless. Indeed, it would be no system at all.

Another important aspect of developing a system is the use of paper trading to develop a win: loss target based upon risk free trials. By using paper trading and simulating real trading behavior and techniques, the trading system can be tweaked and tested without risking valuable capital. Moreover, paper trading provides the trader with the ability to develop solid procedures and develop confidence by seeing how the trading system reacts in real-time and not just back testing.

Developing a well defined and consistently implemented trading plan is essential to becoming a successful and disciplined trader.

8. For days, you have been seeing the same pattern: just before closing, a large bloc trade is made to support at a specific price. You feel confident that somebody knows something and they have been buying at the close or during periods of weakness throughout the day. You have set your stops as according to plan, but with the recent increased volatility of the market, you don’t want to get stopped out. So, you do the unthinkable: you take off your stop-just for today.

As things would happen, you get involved in other matters and by the time you get back to trading, your position has headed south big time and it took you along with it. In fact, the surprise loss has wiped out all the gains you have made for the week (or the month, or the year).. This happens...

(1) Very often (2) Sometimes (3) Just once in a while (4) Never

Answer: Never take the market for granted. When you think that you understand what the market will do and have the arrogance to abandon safety, be ready for a harsh lesson. Once procedures have been established and set forth in your trading plan, never take short cuts. Remember Murphy's Law: "When anything bad can happen…it will usually do so at the worst possible time." Some might even say that there are market makers out there who love to lure in suckers and then lower the boom. But that is just pure anecdote….right? Preventing the "blowout loss" is probably the single most important thing you can do to become a consistently successful trader.

9. You've had a series of winners. Things are really going your way. This is how you imagined it when you decided you'd be a trader. What a feeling! Akin to invincible! You decide to take advantage of the "streak" and step your game up by increasing your position size. But this time your trade starts heading south.... but you don't want your streak to end so you adjust your stop. The result, you give all your accumulated gains back ... and more. This happens...

(1) Very often (2) Sometimes (3) Just once in a while (4) Never

Answer: Overconfidence could be your greatest enemy. This quiz includes two questions pertaining to avoiding the blowout trade. As mentioned in the Answer to Question 8, preventing the "blowout trade" Even once in a while is too much. The damage of "the blowout" trade is probably the single most important thing you can do to become a consistently successful trader. The damage is of the blowout trade is not only done to your account, but to your trading psyche - your overall trading confidence. It must be avoided. The solution involves proper money management and risk management techniques being employed in your trading plan… and having the subconscious assertion to stick to that plan.

10. It all sounds good. Just believe and it will happen. Imagine yourself hitting the ball

300 yards off the tee. Imagine yourself being a successful trader and living the way you want. Imagine…imagine. Yes, it sounds like some new age mantra for scam artists. Indeed, “if it sounds too good to be true, it probably is.” Is this how you feel when you hear such subjects?

(1) Every Time (2) Sometimes (3) Just once in a while (4) Never

Answer: But, if you have actually driven a golf ball 300 yards on the driving range, you know it can be done and it doesn’t seem to be just a possibility but a probability that it can happen. The same concept exists with trading: if you have experienced success while paper trading, you also know that it is possible and only a matter of probability. This is a very important distinction in the process of visualization. Once you believe it can really happen, the only thing needed is the opportunity of circumstances and necessary procedures.

First of all, see yourself as a successful trader by experiencing it while paper trading. Yes, there is no risk but the process is true. Once you know that it can take place, then it’s just a matter of controlling emotion through being a disciplined trader and following your system. But, the power comes from believing- and seeing is believing. Be patient and remember that being a successful trader is a long distance proposition. Discipline and real belief will make it happen. It is fact that you move in the direction of your most predominant thoughts...meaning what your SUB-conscious mind holds as true. It really IS a matter of training your subconscious mind to hold the outcomes you wish, including YOU as the wise and disciplined trader.

Author’s Note: I hope you have found this test and its suggested answers helpful. May you always strive to be The Disciplined Trader and maximize your potential as a successful trader! Good Trading, Norman Hallett, CEO, Subconscious Training Corporation, http://www.thedisciplinedtrader.com