

Learning Flawless Execution of a Trading System by Mark Douglas

The proper execution of your trades is one of the most fundamental components of becoming a successful trader and probably the most difficult to learn. Most traders find it is much easier to identify something in the market that represents an opportunity, than it is to act upon it. However, there are some very good psychological reasons why it is so difficult to act on a trading signal. To understand these reasons, you need to understand the nature of trading systems (defined as any methodology that consistently identifies an opportunity to buy or sell with a potential profit in some future moment) and how these systems interact with the markets and ourselves.

For example, most good trading systems, technical or otherwise, will consistently take money out of the markets over the long run. Most of these good systems have been available to the public for years, and yet, there is still a huge gap between what is possible and what most traders end up with. The problem with trading systems is they define market behavior in limited ways when the market can behave in an almost infinite combination of ways.

Systems mathematically or mechanically reduce relationships in human behavior characteristics to percentage odds of what could happen next. They can only capture a very limited number of these behavior characteristics compared to the billions that are possible. As a result, any identified pattern may or may not be repeating itself with respect to the way the pattern or relationship progressed when it was observed in the past. Therefore, we never really know if it is valid or not until it has actually completed itself. The big psychological problem here is that people have a great deal of difficulty acting on opportunities with probable outcomes.

Outguessing Systems

Most people like to think of themselves as risk takers, but what they really want is a guaranteed outcome with some momentary suspense to make it feel like the outcome was in doubt. The momentary suspense adds the thrill factor necessary to keep our lives from getting too boring. However, when it comes right down to it, no one trades to lose or puts on a trade believing it is going to be a loser, and all systems will definitely have some percentage of losing trades. So it's difficult not to be tempted into trying to guess which ones are going to be the losers and not participate.

As most of you reading this article already know, trying to out-guess your trading system can be and usually is an exercise in extreme frustration. The signals you get from a trading system will have you trading in ways that are completely contrary to your logic and reasoning. Sometimes, the system will defy your reasoning and be right. And sometimes, you will agree with the system and it will be wrong. You need to understand that technical trading systems are not designed to be out-guessed. What mean is, they aren't designed to give you isolated signals of an opportunity to be taken when it seems right. What they do is mathematically define, quantify, and categorize past relationships in collective human behavior to give you a statistically probable outcome of the future.

Purely Random Outcome

As a comparison to trading, it is much easier to take risks and participate in a gambling event with a purely random outcome based on statistical probabilities, simply because it is random. Meaning, if you risk your money on a gambling event that you know has a random outcome, then there's no rational way you could have predicted what actually happened. Therefore, you don't have to take responsibility for the outcome if it isn't positive.

Whereas, with trading, the future is not random. Price movement, opportunity and outcomes are created by traders acting on their beliefs and expectations of the future. Every trader contributes to the outcome of the future by putting on and taking off trades in accordance with their beliefs. Since traders actually create the future by collectively acting on their beliefs about the future, the outcome of their actions is not exactly random. Otherwise why would traders try to out-guess their trading systems, unless they had some concept of the future and how that future will affect the markets.

This adds an element of responsibility to trading that doesn't exist with a purely random event which is difficult to avoid. This higher degree of responsibility means more of your self-esteem is at stake, making it much more difficult to participate in. Trading gives you all kinds of ways to beat yourself up for all of the things you should have or could have considered that would have resulted in a more satisfying outcome.

Think Probabilities

Furthermore, you don't trade in an information vacuum. You form your expectations about the future with information that technical systems don't take into consideration. Consequently, this sets up a conflict between what your intellect says should be happening, and the purely mathematical means of predicting human behavior afforded by your technical system. This is precisely why technical systems are so difficult to relate to and execute. People aren't taught to think in terms of probabilities - and we certainly don't grow up constructing a conceptual framework that correlates a prediction of mass human behavior in statistical odds by means of a mathematical formula.

To be able to execute your trading systems properly you will need to incorporate these two concepts into your mental framework-thinking in terms of probabilities and correlating the numbers or the mechanics of your system to the behavior. Unfortunately, the only way you can really learn these things is to actually experience it by executing your system. The problem is that rarely will the typical trader stay with his system beyond two or three losses in a row, and taking two or three losses in a row is a very common occurrence for most trading systems. This creates somewhat of a paradox or catch-22. How do you do it if you don't believe it? And you won't learn to believe it unless you do it long enough for it to become a part of your mental framework. This is where you employ mental discipline to eventually make flawless execution a habit.

Mental Discipline

When you form any habit, it acts as a force on your behavior. This force exists inside of your mental environment in the form of a belief. Mental discipline comes into play when you need to establish a belief that does not yet exist, and more importantly, doesn't have the support of beliefs in your mental system that already do exist. For example, if you are not a runner and decided you wanted to become one, you may have many beliefs that don't support this expression of yourself. These beliefs will act as resistance to your attempts to run by drawing your thoughts and attention to anything that will divert you from your intent to do so.

Mental discipline is a form of thought control employed to recognize the dynamics of this process, focus your attention back on your goal and purposefully work through your resistance to establish this new expression of yourself. The more you do it, the faster you will establish a new belief that you are a runner. This new belief will then act as a force on your behavior motivating you to run.

The same type of mental dynamics described above will also apply to learning how to properly execute a trading system. You will likely encounter many beliefs acting as force to divert your

attention away from what you need to do, when you need to do it. As a result, you will need to employ mental discipline as a counteracting force to stay properly focused until you build a mental framework that is consistent with this new expression on yourself.

Trading Exercise

To build the mental framework necessary to execute effectively, I suggest that you take some percentage of your trading capital and designate it as money set aside strictly for educational purposes. With this designated capital, then buy and trade a simple trading system with well defined entry and exit points. This system does not have to be expensive. You can get one out of the many books on technical analysis available today or choose one being offered at an investment conference. I think it is important to buy one instead of devise one of your own because it might be a little easier to stay focused on the objectives of this exercise. Any system you devise you are naturally going to want to make money with. Save it for later, after you have learned how to execute properly.

You will also need to find a system that suits your unique tolerance for taking a loss. The amount of money you risk per trade should be an amount that you are completely comfortable with. If you don't stay within this tolerance level, you will be, at the very least, uncomfortable, in which case to whatever degree you are, you shut down the learning process. When you are feeling pain, instead of being focused on what the market is teaching you about itself and yourself, you will be focused on information that will ease your pain. Which usually results in a painful lesson.

Commit to a System

Once you have decided on your system you need to make a commitment to trade this system exactly as the rules call for. You will need to make a very strong commitment here and not play any games with yourself. The object of this exercise is to work through any resistance you may have to following your rules. Taking ALL of the signals generated by your system is the only way you can get the first hand experience you need to establish a belief in probable outcomes, and relating the mathematics to the behavior.

After your system takes three or four losses in a row, it's going to be very difficult to put on a trade generated from the next signal. But you have to do it anyway, in spite of any resistance to do otherwise. When that next trade turns out to be a winner you will have established a first hand understanding of the nature of technical systems and a belief in how you can make money in the long run, if, of course, you can execute your system properly by acting on every signal. Once you establish this belief, you will have the force of habit working for you, and the struggle will cease. So while you are working at it, just do the best you can and look for ways to improve your performance.

Helpful Hints

What you need to learn by doing this exercise will come much faster if you keep in mind that it is not going to be easy (at least not for most people), so be easy on yourself. The more accepting you are of your mistakes, the less fear you will encounter when it comes time to make the next attempt. If your child was learning how to ride a bike, I'm sure you wouldn't scold him for falling off and tell him not to try again. You would encourage him and eventually he'd learn. Give yourself the same kind of understanding and consideration.

What you are doing is more of an exercise in learning trading discipline and the skill of flawless execution, which I am defining as executing a trade immediately upon your perception of an opportunity (inclusive within opportunity is the opportunity to exit a losing trade). In the long

run, having this skill is far more important than your immediate desire to make money. So keep your contract size light. You can always increase it later when you have learned to completely trust yourself to always do what needs to be done without hesitation. Stay with the exercise until it becomes second nature or a part of who you are. As you gain in your confidence, you will learn more and consequently learn how to make money as a trader. As you make money you will gain in your confidence. This positive cycle will expand your ability to be successful just as easily as a negative cycle will feed on itself to end in despair.

Trading Systems vs The Need to Express Oneself Creatively

There is something else here that you need to be aware of. Trading a technical system in a rote manner will make you money but it won't necessarily satisfy your need for creative expression (unless you created the system). Since all traders believe they know something about the market, the most satisfying trade is one based on your own ideas and reasoning process. These kinds of trades are an expression of your creativity, and when they work, nothing feels better. This need for creative expression is a very powerful inner force that is hard to resist, especially for the sake of your technical trading system.

So what I suggest you do is express these creative trades in a separate trading account. By opening up a completely separate trading account for your creative trades and also trading a different commodity, it will help you avoid the inevitable conflicts that would result between what you think and what your system says to do. When these conflicts arise, they diminish your ability to execute your system and have the potential to completely immobilize you to the point where you can't do anything at all, except watch the opportunity pass you by.

By making this kind of distinction and tangible separation between your intellect and your technical trading system, you will be creating for yourself the kind of psychological conditions that will enable you to learn, through experience, the effectiveness and value of your technical system.

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