Trading Psychology – Predictions, the Ego and Anxiety in Trading

Making predictions pulls the ego in, warps our trading psychology, and sets us up for trading difficulties. We all seem to admire someone who can pick the high or low within a tick, don't we? Wouldn't it be great if we could do that? If anyone actually can do it, we put them on a pedestal and make them into a trading hero.

If we look at this carefully, though, we can see the ego emerging. If I can make a prediction and be right, I must be great. Prediction also flies in the face of trading as a discipline based on probabilities. It gets us into trouble.

Which Is More Compelling?

Here's a question for you to answer. Which seems more compelling or appealing, Choice A or Choice B?

A. I can predict the high and the low within a few ticks.

B. When the birds stop singing and the sky darkens, it's probably going to rain.

Most of us would probably select Choice A, even though we know in our heart-of-hearts that B is the better answer for trading the markets. We choose Choice A because it reflects what psychologists call ego-syntonic. It strokes the ego because it places "I" in the driver's seat ("I predict"). Our egos *love* that. In Choice B, there is no ego, there is no "I." *The birds are driving the bus!* Not too appealing to the ego.

What Psychology Says

There are psychological reasons why it less likely that we would select Choice B. From behavioral finance, for example, we know that people in general ignore base rates, or the probability of an event. Researchers have discovered that most people will ignore probabilities in favor of familiarity, a single prominent quality, and other non-probabilistic features, even when they know probabilities are important. This is one of the reasons we respond to gurus. We listen to the hype that the guru has predicted the last market rally perfectly from the bottom. That's salience. But we should see how this guru does over the next 10 bottoms.

There was a relevant study in behavioral finance that created a simulated trading environment and had groups of people trading a variety of things. Just before trading, some people's egos were mildly challenged. Although the ego challenges were randomly assigned, the ego-challenged traders performed consistently worse than traders who were not challenged. Apparently, protecting the ego was more important than good trading outcomes.

Ego and Anxiety and the Effects on Trading

We all know, too, that when the ego is on the line, anxiety goes up. Most people would say that choice A is more stressful than choice B, other things being equal. When stress rises, our cognitive abilities plummet. We miss obvious things and tend to make poor choices. The most recent research is showing that poor outcomes related to stress can be due to a heightened focus on internal thoughts and sensations. When we are under stress, our cortical activity increases and in a very real sense, our focus shifts from what's happening in the market to what's happening with us, though we may not be fully conscious of this at the time.

Anticipation vs. Prediction – Let the Market Decide

I always like David Mathys' (prior training director at Wyckoff/SMI) idea that it is much better to anticipate than to predict. Prediction has a hard edge to it. You are either right or wrong. Anticipation has a less hard edge. It has a softer focus. You can be more open to possibilities, such as base rates and the probability that the trade won't work out. You are also more open to what the market is saying because it is a less stressful posture. Anticipating the rain by noticing that the birds stopped singing rather than predicting it will rain is what Mathys advocated for trading.

I used to trade Wolfe Waves with another trader. He was an excellent trader and was very successful trading just this one pattern. But it wasn't because he could identify the buy and sell waves; a little training and anyone can do this. His success was due to his attitude towards his trades. He would put a trade on and then always say, "OK, I've done my part. Now it's up to the market to decide."

This was his mantra, and he always made a point of saying this with every trade. He acted very much like Choice B: He anticipated a change in direction, and then let the market drive the bus. Whichever way the trade turned out was OK with him. He did his part. He focused on the process that he could control, and did that well. In doing so, he was able to let the trade outcome go. His ego wasn't involved. Few of us seem to be able to do that. This may be one of the reasons why many of us find trading so difficult.

Suggestions for Traders

Here are a few suggestions you might want to consider to address ego, predictions, letting the market decide, and becoming a psychologically savvy trader:

1. **Focus on the process of trading, not the outcomes**. Keep your attention on selecting the trade, assessing the reward potential to risk, making the entry, setting your stop, managing your trade, and finding the exit. These are the processes of trading and these are where your attention should be. If you are worried about the trade outcome – whether the trade is going to be a winner or a loser – you have already lost.
2. **Keep a probabilistic attitude about trading**. Understand and accept that trading is based on probabilities. If you have a trade setup with an edge, then you know it won't work out every time, but it will lead to profitability over a large number of trades. Maintaining a probabilistic attitude also helps with a focus on process rather than the outcomes. When a trade fails, it's expected. It is simply one of the trades that had the odds of not working out.
3. **Be aware of when your ego is pulled into a trade**. Learn to recognize the signs that you've been hooked into believing you have to be right. It might be a tension in the body or thoughts

of fear of a loss, or even the opposite: thoughts of grandiosity. Whatever your pattern, learn to recognize it so that you don't get ambushed by your ego and make errors in your trading.

4. **When you notice your ego in the trade, take specific steps to address it**. First, acknowledge it. You can even say to yourself, "Ah, there's my ego at work" if that seems to help. Second, don't fight the ego, try to suppress it, or get down on yourself in any way. We all have egos, and they can be quite valuable at times, though trading is typically not one of those times. Accept it as a natural part of being human. Finally, turn your attention back to the process of trading. Focus on whatever you need to do next for your trade and put your full attention there.
5. **Learn mindfulness skills if steps 1-4 aren't enough**. Mindfulness is increasingly being recognized as a highly valuable practice in psychology, and traders can take advantage of its many benefits. The practice of mindfulness can help you cultivate a mental space that is less responsive to the internal mental chatter that is so unhelpful for trading. If there is a holy grail of trading psychology, mindfulness may just be it.

You can learn more about mindfulness and other aspects of trading psychology – including free mindfulness skill builder video exercise and trading psychology mental skills ecourse – at the author's website http://www.TradingPsychologyEdge.com