Appendix F: On Fear

Traders will find it next to impossible to work their way through the typical book on trading without being exposed to the subject of "controlling one's emotions". Indeed, the conventional wisdom demands that controlling one's emotions is absolutely essential to trading success. And, technically, that's true. If one has them. But, contrary to conventional wisdom, emotions are not an unavoidable component to trading (granted, those who insist that emotions are unavoidable consider the selection of a shirt or of sunny-side up vs over easy to be emotional decisions, but this is about neurotic behavior: addictive, compulsive, illogical, irrational, obsessive, self-defeating, self-damaging behavior; revenge trading is neurotic behavior; cutting profits short and letting losses run is neurotic behavior).

By "emotions", the Wise are referring to The Big Three: Fear, Hope, and Greed. And withstanding all of these, much less controlling them, can seem insurmountably difficult. Hope, however, is only the fear that all will not turn out as expected or anticipated, and greed is the fear that one will either "miss" all that a particular opportunity may provide or that he will miss the opportunity altogether. Fear is the nexus.

But fear of what? Left to its own devices, fear can be invasive and seem all-encompassing. But if we examine it closely, we can see that "fear", with regard to trading, can be reduced to two elements: fear of being wrong (ego damage) and fear of losing money (destitution). Focusing on fear in this manner makes it manageable, even dispensable. Why? Because if one has **a thoroughly-tested and consistently-profitable trading plan**, there's nothing to be afraid of. If one follows it.

The novice is to be envied. He has nothing to unlearn and has no preconceptions. If he is curious, able to concentrate, is reasonably intelligent, and is able to work without investing his ego in either the process or the result, fear has no opportunity to intrude. And if he is working with the aforementioned plan, trading emotionlessly becomes a matter of course, like changing one's spark plugs.

The "experienced" trader (struggling, perhaps failing), on the other hand, not only knows a great deal that isn't so and thus has to be unlearned, he is also a bundle of neuroses, obsessively questioning his perceptions, his decisions, his actions (or, just as likely, his inactions). And running through his head almost without pause are the voices: so and so says, or I read somewhere that, or I took this seminar once that, or this book said, or but the ADX says. He has spent embarrassing amounts of time (and often money) in a search for instructions as to where EXACTLY to draw the line, EXACTLY where to enter, EXACTLY where to exit. This search is in large part what makes Pivots and Fib and Gann and MAs and so forth so seductive. One doesn't have to think about just where it is that price (traders) really react. All the trader has to do is draw the calculated lines. This search for exactitude also motivates the search for the EXACT stop and exact TYPE of stop that the trader should use, along with the EXACT trigger and the EXACT target. But if it were all that simple, one could package it into a kit and sell it (4x Made Easy and Weekend Seminar – lunch included). Learning how to trade properly from the beginning, with the aforementioned trading plan, would have enabled the struggling trader to avoid all this turmoil and become consistently profitable, if not at the outset, then close to it. But there's no going back, this side of amnesia, so wanting to is simply wishful thinking.

All is not lost, however. Though the struggling trader can't go back and start over, he can reprogram himself, rewire himself. This may take more discipline than he's capable of, but it's either that or continued losses and eventual bankruptcy.

The reprogramming begins with becoming intimate with fear, nuzzling up to it, licking its ear. Unless and until one addresses fear directly, eyeball to eyeball, he will find it impossible to bring about its evaporation.

<u>First</u>, realize that the fear of being wrong and the fear of losing money can be consolidated and simplified further by becoming acquainted with their father: the fear of the unknown. By this I'm not referring to the fact that the outcome of any particular trade is unknowable; I'm referring to the fact that the struggling trader rarely understands just what it is that he's looking at.

<u>Second</u>, one must know just what it is that he's looking *<u>for</u>*. If he doesn't know what he's looking for, ipso facto he won't recognize it when he sees it. If he doesn't recognize it when he sees it, he of course will not what to do with it. And if he doesn't know what to do with it, it's a cinch that whatever he does will very likely be the wrong thing (fear of being wrong). And not only will he be doing the wrong thing, he'll be doing it at the wrong time. And doing the wrong thing, especially if he's doing it at the wrong time as well, he will very likely lose money (fear of losing money).

<u>Third</u>, the task then becomes to transform the fear of the unknown into a confident ease with the known. And one accomplishes that by developing a (you guessed it) thoroughly-tested, consistently-profitable trading plan. In order to realize a consistently-profitable trading plan, one must thoroughly test the elements that go into it. In order to thoroughly test those elements, one must define them precisely (e.g., what is a "range"? what is a "breakout"?). And once one knows exactly what he's looking for, he will know it when he sees it. And when he sees it, he'll know exactly what to do with it. Fear becomes irrelevant. The trader may in fact be so focused on his plan that he isn't even aware of fear's departure.

The trader who develops his own plan is in an arguably superior position due to his creating it step by step, block by block, from raw data. The fact that he is developing it himself and the process that he goes through in order to do so guarantee that he will have confidence in it. Whether or not he has the discipline to follow his own plan is another matter, but at least he will have no reason to distrust it.

The SLA/AMT, however, is pre-packaged, ready-to-go, turnkey. All one has to do is follow the rules. But damaged traders are the least likely to follow the rules of a plan they didn't put together. Given that they are unlikely to develop their own plan from scratch, though (if they were, they would have done it already), the SLA/AMT or something similar may be their best shot. And it doesn't cost anything. Nor does one have to have a fancy, bells-and-whistles charting program to trade it.

So how do you go about learning to trust a plan you didn't create, at least enough to trade it and profit from it? Begin by learning the language. Just as you have to know what a full house and a straight flush are if you want to play poker, you have to know what a range is and how to recognize it, first on static charts, eventually in real time. You have to know what a trend and a trend channel are and how to recognize them. You have to know what a reversal looks like and a breakout and a retracement and you have to know how to trade all of them. You have to know what a swing point looks like. You have to know what a double top and a double bottom and a lower high and a higher low look like. You have to be able – and don't laugh – to distinguish between up and down.

And you have to be able to draw a straight line.

All of this is explained herein, but you can't and won't become a master at it by skimming it once and jumping right back into the pit. You must **practice**, preferably in replay. You must develop the ability to **concentrate**, if only for fifteen minutes (if you're daytrading). Then a half hour. Then an hour. You must develop **focus**, turning off the TV, shunning message boards until after your session, ignoring the news. Concentration without focus is pointless as you must have something on which to focus in order to concentrate on it. In other words, concentrating on something that is more or less meaningless to you isn't going to get you very far.

Fear cannot be dissolved unless and until one achieves **competence**. If one believes he is competent to solve a problem, fear becomes much less a factor, and the more competent one becomes, the less influence fear has, if any. How is this competence achieved? Same as how one gets to Carnegie Hall: practice, practice, practice. And by "practice" I don't mean watching somebody else practice or reading the results of somebody else's practice; I mean engaging the market oneself, walking right up to it and shaking its hand, sitting in front of a live chart, either via replay – in which case you can do it anytime, at your own convenience -- or real-time or delayed quotes, and focusing on a series of tasks, e.g., is price rising or falling? Is it trending? Ranging? Concentrating on what price is doing and how it's doing it (quickly or slowly or forcefully or hesitantly) and where it's doing it (if in a range, where in the range). Trading what you understand – or think you understand – about these movements, win or lose. Then, after your session is over, completing a task which hardly anyone begins, much less completes: **the chart review** (if observing) and **trade review** (if you tried any).

Trade reviews usually end up being a couldawouldashoulda pity fest. And while they may provide a milky comfort of sorts, they do not come close to providing a plan of action, much less one that will improve one's performance and results. In order to formulate such a plan, you must get past the I'm Such An Idiot hurdle and begin to look at the errors you made and why you made them *and what you plan to do to avoid making them again during the next session*. Look also at what you should have done instead and what specific steps you plan to take to do it right at the next opportunity. If, for example, you're still hesitant about where to draw a line or you have not yet decided upon a satisfactory definition of a "break", then you are ill-equipped to put fear in its place, much less kick it to the curb.

"Just follow the rules" is not enough if one has not internalized the rules and cannot apply them without hesitation and without thought. Trading with "discipline" if one is trading a plan he doesn't trust is not productive. Fortunately, there are a few tweaks* that are required of the trader in order to make implementation a success. I say "fortunately" because the trader is more likely to trust an approach that he had at least some say in as opposed to something that he's handed that he's expected to follow without question. And if he doesn't trust it, he's not to going to follow it without hesitation.

Hesitation is the stick in the spokes, the bomb in the hold. Hesitation is a sure sign that you're not ready, and if and when it makes an appearance, you should stop instantly, lean back, and breathe. You have no control whatsoever over price movement, *but you have complete control over how you respond to it*. How you respond to it, however, must be based on the decisions you've made, not on how you "feel". These decisions begin with **preparation** (see the Afterword), pulling up the weekly and daily and hourly charts so that you have a clear idea of where you are. Determining whether or not you were and/or are in a range before the opening bell. Where you are in that range, if any. What its limits are. Where you plan to go long and short out of it. All of these decisions can and must be made before the session even begins.

And when the bell rings? It is not possible to know exactly what the market will do once the opening bell rings much less what it will do once one has entered a trade. But there is a world of difference between the trader who tenses up and holds his breath while the trade unfolds -- hopefully away from his entry point -- and the trader who understands that anything can happen and anticipates the market's moves, is fully confident that he knows how to deal with those moves, and that he will act appropriately when required to act. If the focus is on these elements, there is no space for fear. It becomes an indulgence.

The trading game is not won in the strategy one selects.
The trading game is won in the mind.

The Scratch

The scratch is probably the best idea to come down the pike since digital charts. It functions much like a microchip implant, flicking you into auto mode when you're about to do or have just done something stupid. Not only when events go against you but when they even LOOK like they're going to go against you, you can scratch and defuse the whole situation, leaving you clean and unsullied with time to breathe and calm down and think and elbow fear in the gut before he has a chance to mess with you.

The most obvious and frequent use of the scratch is the precipitous exit from a trade. I say "precipitous" because the exit will almost certainly be too soon. However, when the heart stops and the brain freezes, "too soon" is not on the table. What is absolutely paramount is getting out and getting out fast.

A common scratch occurs immediately after an entry. The trade doesn't go the way you expected it to go, but instead of falling back into the warm and welcoming arms of hope or giving in to that gut-wrenching feeling when you see yourself living in a box under the bridge, just get out. Instantly. Without even thinking about it. Just get out. Scratch it. What have you got to lose? A tick? A point? Just get out. And if the trade ends up going in the direction you had expected it to, so what? You can deal with that if and when the opportunity presents itself. In the meantime, you're out. You're clean. You're calm. You're fearless. Your vision is beginning to clear. *And you had the discipline to do what needed to be done.*

Another common scratch occurs the first time price moves against you. This may happen in seconds, immediately after the entry, as discussed above. But it may not happen for what seems like minutes, though it can be much less, particularly if you've managed to grab onto a rocket. At some point, this rocket will begin to run out of fuel and sputter and retrace a bit. How much room are you willing to give it? How much CAN you give it before your bowels begin to loosen? Regardless of whether or not you objectively should exit this trade, it should be scratched as soon as you begin to fear the outcome. Immediately. Without thinking about it. Whatever happens after can be addressed after.

One cannot go on like this, of course. While scratching ensures minimal losses, if any, it also ensures that your profits will be far less than they would be if only you had let them run.

But maximizing profits is not the point of scratching. Its purpose is to reprogram you into understanding at a behavioral level that you are in complete charge of whatever happens to you. That you decide when and how to enter and when and how to exit. Once you've reached this state, fear is an afterthought, if one thinks about it at all.

You'll find all sorts of opportunities to scratch, the number depending on how much reprogramming you need, i.e., how screwed up you are. But one common opportunity which to me is essential to the trader's growth but which few people even think about has to do with **concentration** and **focus**. Trading requires that you **pay attention**, but it must be attention of the right kind. You've planned, you've prepared, you've reviewed the decisions which have been and have yet to be made, you're psyched, you're ready to go. An opportunity presents itself, you take advantage of it, and then everything goes to hell. Instead of concentrating and focusing on price and what it's doing and where and how, *you're thinking about your trade* and whether or not it's in profit and if so how much and how much danger it's in and should you give it room or scratch and what about that loss you took and can this trade bring you back to breakeven or maybe a little profit besides or maybe more than just a little and there you are back where you started, fear sitting on your chest. Though it's difficult to pull off, scratching when one's mind begins to wander is an excellent, straightforward, and efficient way of not only smacking yourself for wandering off onto the wrong thoughtcourse but of bringing you back to the straight and narrow. It's so effective, in fact, that even the mere thought of scratching may be enough to bring you back into focusing on what you ought to be focusing on – price behavior – rather than on your trade and its status. And if you've been giving it the old college try and doing everything right but fatigue begins to set in and you're losing focus not because you're thinking of the wrong things but because you're just so damn tired, then stop. Exit and stop. The market will be here tomorrow (unless it's Friday). So will you be if you don't kill yourself with overwork.

Remember: <u>the best plan is of no use if one is afraid to follow it</u>. Scratch when you have to, for as long as you have to. Nobody is going to know if you don't tell them. And when you get to the point where you can trade emotionlessly, you'll be better able to detect fear in others by the way they're moving and reacting to price and to use that knowledge to your advantage. All's fair.

*1. What constitutes a "break" of a line? A tick? Two ticks? A point? Two? Five? Ten?

2. How far are you willing to let price travel against you before deciding that you need to exit? A point or two or three below a demand line break (in an uptrend)? Half the distance of the most recent upwave? All the way to the last swing low? All the way back to where you entered in the first place? When you conduct your review, did you exit out of fear? Or did you have a good reason? A really good reason.

3. Where are you going to enter a breakout? A tick above the upper limit of the range? Two? A point? Two? Are you going to use a hard stop? How much? Will it be fixed or trailing? When will you move it to breakeven? Why there and not someplace else?

4. Where are you going to enter a retracement? A tick from the deepest part of the trough? Two? A point? Two? How have you defined "trough"? Have you defined it at all?

5. If a higher low prints before the supply line is broken, are you going to go ahead and take it? Or wait for the line break and retracement? What if there isn't a retracement? What if the higher low was enough? Are you going to feel like a dummy for not having entered on the higher low? (Ditto a double bottom.)