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**Today's Stock Traders' and Investors' Complimentary Wrap is based on EXTRACTS from Edition 487 and 488 of our Mentoring style *'Investing & Online Trading'* Stock Market Report**

# Top 10 Reasons Traders Lose Their Discipline

### *By Brett Steenbarger, PhD*

Dr Steenbarger is the author of '*The Psychology of Trading'* (Wiley, 2003), '*Enhancing Trader Performance'* (Wiley, 2006), and '*The Daily Trading Coach'* (Wiley, 2009) with an interest in using historical patterns in markets to find a trading edge.

He is also interested in performance enhancement among traders, drawing upon research from expert performers in various fields. A valued contributor to Jim Berg's *'Investing & Online Trading'* Report since its launch in 2005, we thank Dr Steenbarger or the following article:

Losing discipline is not a trading problem; it is the common result of a number of trading-related problems.

Here are the most common sources of loss of discipline, culled from my work with traders:

**10)** Environmental distractions and boredom cause a lack of focus;

**9)** Fatigue and mental overload create a loss of concentration;

**8)** Overconfidence follows a string of successes;

**7)** Unwillingness to accept losses, leading to alterations of trade plans after the trade has gone into the red;

**6)** Loss of confidence in one's trading plan/strategy because it has not been adequately tested and battle-tested;

**5)** Personality traits that lead to impulsivity and low frustration tolerance in stressful situations;

**4)** Situational performance pressures, such as trading slumps and increased personal expenses, that change how traders trade (putting P/L ahead of making good trades);

**3)** Trading positions that are excessive for the account size, created exaggerated P/L swings and emotional reactions;

**2)** Not having a clearly defined trading plan/strategy in the first place;

**1)** Trading a time frame, style, or market that does not match your talents, skills, risk tolerance, and personality.

# Trading Discipline: Cause of Problems or Effect?

## *By Brett Steenbarger, PhD*

Among the dozens of submissions for the Trading Coach Project, the issue of discipline--***sticking to plans/stops--was far and away the most common problem reported by traders.***

My general experience is that lapses of discipline are usually the result of a problem, not a cause. A key challenge, then, for work on oneself is identifying the cause of the departures from prudent trading.

There are three frequent causes worth investigating:

### 1) Personality Traits

Some people score low on a trait called Conscientiousness. They do not plan and follow through well, and they can be impulsive. This, of course, can manifest itself as a problem with discipline in trading.

The key to identifying whether or not personality is a cause of discipline problems is determining whether a similar loss of discipline occurs in other facets of life (outside trading).

If a person is disorganized and lacking in conscientiousness in their work, social relations, personal finances, etc., then it makes sense that this trait would carry over to their trading.

Such individuals frequently need external brakes on their trading, such as risk managers at a firm who will enforce a "drop dead" level (and prevent further trading) once a loss limit is hit.

Individual traders with impulsivity and low conscientiousness benefit from very explicit, structured rules that they follow without variation and reinforce with mental rehearsals.

If the lack of discipline is so great that even such rules and rehearsals can't work, I personally do not believe such individuals should be trading. This includes traders with clearly addictive patterns of behaviour, both in their trading and in other facets of their lives.

### 2) Market Volatility

Many, many times traders are quite conscientious and self-controlled in most areas of their lives, but experience lapses of discipline specific to trading.

When this happens, it's often the case that the trading itself--*how* they're trading--is artificially creating the failure to follow trading rules.

A key culprit in all this is market volatility. Volatility changes from day to day and week to week.

It also varies as a function of time of day.

Frequently, traders trade a fixed size and set fixed targets and stops, heedless of the underlying market volatility:

- *In a low volatility environment*, they fail to hit their targets and get stopped out, criticizing themselves for leaving money on the table.

- *In an environment of enhanced volatility*, the market will blow through their stops or exceed their targets, leaving them feeling that they did not trade well.

  This is especially true when traders find themselves unable to take what is normal heat in an environment of raised volatility.

  In such cases, it really isn't a lapse of discipline causing the problem. Rather, the trader is not adapting to market conditions.

Adhering to fixed rules in a variable environment is not necessarily a virtue. Changing markets can prevent us from enacting those fixed rules.

## 3) Position Sizing

It is very common that smaller traders or aggressive traders will see a good trade and place too large a bet (i.e., a bet that is large relative to their account size). This makes it difficult to ride out normal movements against the position and leads to frustration and emotional arousal that result in loss of discipline.

A good way of determining whether or not this is the case is to compare your largest trades with your smaller ones.

If discipline problems tend to occur on the largest positions, you know that the increased perceptions of risk are interfering with consistency.

The answer to this problem is to size all positions in such a way that individual losses in a trade cannot prevent you from making money on the day; losses during a day won't prevent you from being green on the week.

Large trades relative to position size run the risk of ruin: a series of losing trades can dig a monstrous hole for the trader and cause significant emotional damage.

In a sense, *trades should be boring*--not so large as to create undue fear *or* excitement. It is easiest being consistent and maintaining discipline when those emotional factors don't kick in.

It is common for trading psychologists to emphasize that our psyches affect our trading. Equally true, however, our trading affects our emotions:

- Trading inflexible strategies with inflexible targets and stops

- Trading size that is too large for our personal risk tolerance and account sizes:

both of these can create "discipline" problems even for conscientious traders.

Trading well is often the best psychological strategy of all.

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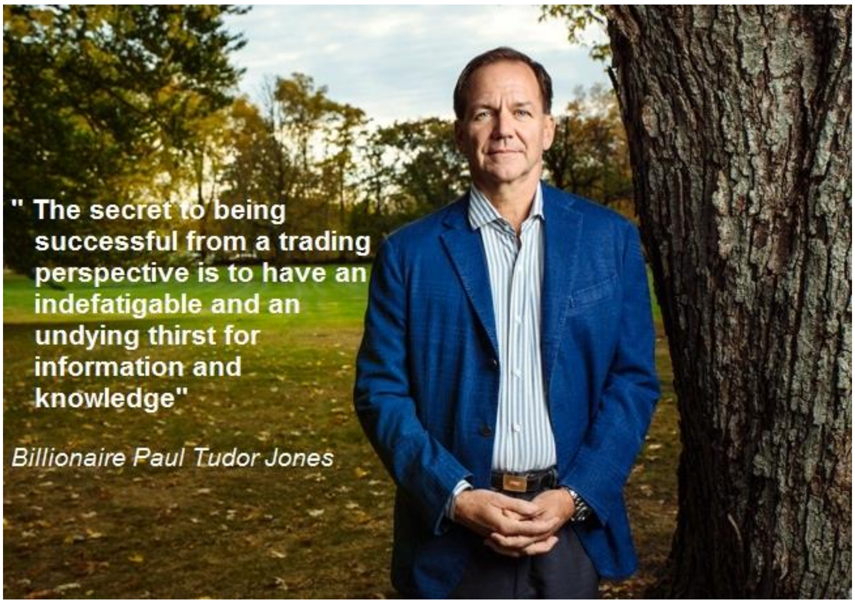


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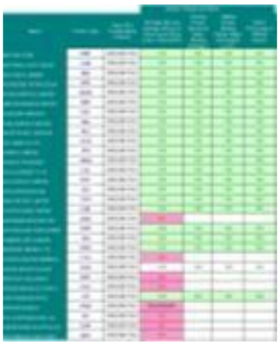

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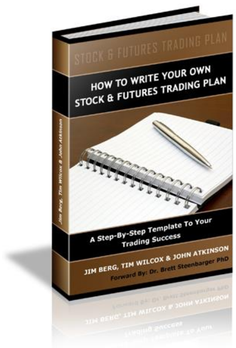


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