



## Lesson 9

# Trading Psychology - Greed & Fear

Besides all of the fundamental and technical factors a trader must keep track of in order to be successful, there is another area which is often overlooked – *themselves*.

No matter how good your strategy is, the other factor which will always influence your outcomes are your own emotions. After all, it is emotions that move the markets. Emotions are what most of our indicators are designed to give us a measurement of. And in order to be able to profit on market movements created by the emotions of others, you must first learn how to read the mood behind the move, and also how recognize and control your own.



## Greed

As prices rise, they naturally attract more attention. As more and more people jump onboard the rally, its climb accelerates. But in all the excitement, there is a tendency to confuse account *balance* (the amount actually on your account) with account *equity* (the total value including the sum of your open positions). People begin to treat their potential profits as if they were already realized. This expectation can sometimes cause basic reversal signals to be overlooked.

Additionally, those who missed out on the opportunity early on, when the trend was still young, are becoming hypnotized by the length and size of the rally. Jumping onboard late is a risky game, however, as those who got in early will eventually need to take their profits. There is also a bit of the “greater fool” factor, as anyone who is still buying is now buying at a higher price, and from a seller who has reason to believe the move may soon be over. The idea then is that hopefully someone will keep on buying after you, at an even higher price, when you eventually decide to become a seller yourself.

## **Fear**

When prices start falling, they awaken fear and panic. Fear is one of our most primal emotions, which explains why prices often fall faster than they rise. People holding longs run for the door trying to sell as quickly as possible, and short sellers motivated by the falling prices add their own orders to the mix as well. When those short orders are eventually covered in order to realize profit, there are temporary rallies which can give false hopes.

This crowd mentality frequently creates moments of market imbalance which can be capitalized upon, once one can learn to recognize the signs and interpret them correctly. Above all else, the key to developing this skill is practice.

## **How Emotions Manifest on Charts**

One of the key measurements of market sentiment is support and resistance. If resistance breaks, there are more bulls in the market at that time than bears. If it bounces, we know the bears have overpowered the bulls. Likewise, if a support level holds, we know that any drops in price were most likely caused by routine profit-taking. If it breaks, on the other hand, we know we have short sellers entering the market along with longs starting to close their positions.

Another indicator that mood and sentiment in the market may be beginning to change is momentum. Declines in follow-through on moves can often signal a drop in enthusiasm and increased likelihood of a pending reversal. Both trend-following and oscillating indicators can give us some clues and insights in this regard, especially as divergences begin to appear on the chart.

Lastly, there is *volume*. Often overlooked on forex charts due to the lack of a centralized exchange (though still worth paying attention to even if it is only the volume from your own broker), volume should typically increase as trends accelerate in either direction. If volume suddenly starts to drop off, it can signal an impending end to the trend in question, or at least some turbulent times ahead.

## **Learning to Control Your Own Emotions**

The first step to becoming a more disciplined trader and having control over your emotions is becoming aware of them. If your results are not consistent, take a close look to see if you are indeed following the strategy you outlined for yourself. Are you entering and exiting positions due to a well-defined signal, or was there some other reason?

Here are some of the most common “symptoms” to watch out for, especially if you see the pattern occurring with some regularity:

- Getting out of positions too early, only to see them continue on in the direction you were hoping they would go is a sign of fear.
- Staying in positions too long and watching the markets take back some of your profits is often a sign of greed.
- Closing a position for a loss, only to see it reverse and go back above break-even moments later is a sign of fear.
- Not closing a losing position, and letting small losses become larger ones in the hope of a reversal that never comes can often be a sign of greed.
- Jumping into a trend late, after much of it has already happened without you, can stem from a fear of missing out on the move.
- And jumping in too early, before the market’s given clear evidence of a direction, can be driven by greed.

It is important to take a step back and really have a close look at what is driving us into and out of the markets. Is it really the strategy and signals we have outlined for ourselves (which should be easy to verify), or is it something else? Our progress in the markets can only be as good as the records we keep, and the time we spend reviewing them. And when we hear news in the markets, it is important to do a quick reality check to make certain we’re giving both positive and negative news the same weight in our evaluations, and not allowing our biases towards a position interfere.

By far the absolute best time to set both targets and stops is *before* you enter the position. Once the hopes and stresses of the market become your own, we can rely less and less on clear and sound judgment.