TAYB 003 – What Is A Good Trading Decision?

Steve: [00:00] Hello, I'm Steve Ward and welcome to Trade at your Best. In these podcasts I'll be drawing on research and practice from the fields of psychology, physiology, neuroscience and peak performance combined with my own experience of working with thousands of traders at institutions across the globe to provide you with knowledge, insights, and practical strategies that I hope will help you to trade at your best and achieve your trading potential.

[00:37] In today's episode we're going to be thinking about trading decisions. What is a good trading decision? What is a bad trading decision? The relationship between your decision-making process and your results and perhaps one of the most important psychological approaches to take that can help you to make better decisions and improve your trading performance in general.

[01:02] I'd like to invite you just to think about the best trading decision that you've made in the last twelve months, and now take a moment to think about the worst trading decision you've made in the last twelve months. And just think now so when you were thinking about that best decision, was the outcome also good, so was that a winning trade? So did your best-trained decision also have a winning outcome, and then think about your worst decision and just think about did the worst decision have a bad outcome so was that a losing trade?

[01:48] And if you're like most people, then that probably is true that your best decision also had a good outcome and your worst decision had a bad outcome, and it's just a really quick way to illustrate how strongly we connect the quality of the decision, whether it's good or bad, with the outcome but that can be misleading. So there's a great book called winning decisions by two guys called Russo and Shoemaker and they have like a matrix, really sort of four quadrants wherein very simple terms they talk about good process and bad process. They imagine that going down horizontally and then going across the top you've got a win and a lose, so essentially, you've got four possible outcomes. You can have good process, so you did the things that you know you should have done and they win, and obviously, that's a great outcome.

[02:39] Sometimes though you do all the right things and this is very true in trading, but you might end up with a loss and then, of course, you cannot do the things you know you should have done so the process was bad and you can actually win from those trades, which it can be very seductive but unhelpful, and of course those trades can also lose. And I think it's really important when we talk about trading decisions and trying to get better at making decisions that we keep in our minds that connection between the process, the steps you took to make the decision and the outcome, and then when we're assessing, was it a good or bad decision that we are not too quick to get sucked into or even fooled by the outcome of the decision as the determining factor. But we also looking at the process, the steps that we took and certainly where you're working in environments that are probabilistic like trading is, is really important to recognize the importance of the process.

[03:39] And one thing I certainly took out from my work with professional poker players was just how often in poker they're making good decisions, they're playing the right hand, but they're losing the hand so the outcome is bad and that's obviously just do the variance, and trading can be quite similar.

[04:01] What's interesting in that quadrant where you're doing the right thing and you're losing is psychologically that can be challenging and I remember working with some relatively young traders or newer traders, an investment bank many years ago and part of the challenge they were having and the reason why we were doing the training was that they were having an extended run of losses, of drawdown. They were struggling. It was becoming more and more challenging psychological and yet in amongst all that they were doing a lot of the right things. So quite often in life, if you do the right thing, then you work hard and you apply the right effort into the right places, you get good outcomes. Yet we see in trading that the linkage between the process and the outcome, the correlation is not always that strong.

[04:51] Over time doing the right things will probably get you good results, but in the short term, on the next trade it may or it may not. So it's very important psychologically for us to separate process and outcome and to be able to look at both not just to get to sucked into the outcome, but of course, for us and for the brain judging the outcome makes perfect sense because it's easy to do. It's a number and is that number better than expected or worse than expected. Is it better than the previous number or worse, so it's very easy for the brain, but in terms of decision making, it's far more complex and it's more nuanced than just that number. So kind of really becoming curious and getting interested in how did I make the decision and the environment I made the decision in, so the context, the market context and your own kind of personal context gives us a much greater place to work from and to understand and also to be able to improve.

[06:01] So there's some pretty interesting research if we start to look at what happens when we may be focused too much on the results of a decision versus if we perhaps focus more on the process of how we made a decision. So the research around being too results-focused shows there were a few factors which happen, which are probably unhelpful. The first one is that performance anxiety is increased and that reduces your cognitive capabilities, so your ability to think and to actually make those decisions.

[06:34] Secondly, the loss of version is increased when people are overly results focused so we start to worry more about losing, and again that will tie into the anxiety and increase in the stress response. Interestingly, a focus on outcomes also lead to an ambiguity aversion so people become more averse to uncertainty. They look for outcomes which have a higher certainty so we're almost looking for the perfect trade as opposed to a good trade. So there's a fine line there, and finally something that's pretty interesting is that when we become very results-focused, and again it probably ties in with that previous point, is people become much more prone to trying to collect and use all available data whether it's useful or whether it's actually useless. But there's this need to kind of get confirmation of the fact that we're right and again I think that ties into the loss of version and the ambiguity of version.

[07:35] They're all happening in the short term. What's interesting is the research also shows that in the longer term where people stay overly results focused it reduces innovation, it reduces learning and it reduces risk-taking. So it's hard for us to not be aware of or pay attention to the result, but I think what I'm really saying here is there is a danger very clearly to being overly results-focused.

[08:09] The alternative is we start to shift some of that energy and attention and focus into the process and maybe it's a balancing of both in the real world, but the research shows that where people are more process-focused so where you start to pay more attention to how you made a decision then that's actually very important to success where you're operating in a probabilistic field such as trading. One thing it does is it reduces mental blind spots so it has a big impact on being able to reduce maybe some of the behavioural biases that we might be prone to.

[08:43] It reduces emotion-driven decision making and again, there's lots of talk about the role of emotion in trading so anything we can do that helps that it's probably useful. It also engages the deliberate mind and this is really the part of the mind, again, it's going back to a previous episode, it's like your observer self, the parts which is noticing but also is regulating. So it's kind of keeping your attention in the right place. It's enabling you to take the action you need to take. It's the monitoring if you're going off track and being able to bring yourself back on and again, the deliberate mind is a key part in the mechanism of trading discipline.

[09:24] And then the final piece again, which I think is really key and touched on previously is the process focus enables you to place your attention on what's important. So in this moment or in that next moment, what's the action I need to take that's going to be helpful for me? And again, the reality is it's probably a balancing of a results-focused with a process focus but if we can bias that towards more about the process and then almost allowing the outcome to happen, then that psychologically is probably going to be very, very helpful.

[09:59] Now I want to just share with you I guess a quick example, a case study of a trader I worked with and this is going back a few years now of the potential negative impact of a results focus and how being more process-focused can be very, very helpful. So I was working with this trader and we were doing the work probably from about September through till December time and one of the topics that he decided he would like to work on was to address a challenge which he felt he would be facing in the future. And that challenge was that at the end of December, the P&L for this trade is reset to zero. He's working in an investment bank and then they start the new year obviously on the 1st of January, but with a zero P&L and this is a trader who's very experienced, been trading for a large number of years, been very successful, been very consistent, but the challenge is that when the P&L is reset to zero, he has this massive overwhelming anxiety and stress for the first few weeks or months of the year until he puts some runs on the board, until he generates some P&L.

[11:08] And what's happening is obviously he is so focused on not losing it and obviously those of you who are trading in that situation, you will know how the dynamic can change, the worry and the anxiety of losing is often experienced more greatly when the P&L is zero or lower as opposed to when we've got that kind of cushion, for want of a better word. So what was interesting was not only did he get the anxiety in a stress so kind of the emotional experience, but over the past few years he'd also developed a stress-related eye twitch.

[11:42] There was a physiological manifestation of that stress, but only in that part of the year until he obviously made some money, he would calm down, settle down and get back into his normal trading flow. So what we worked on in our work together from that sort of September period through to the December was finding ways to help him to become much more curious and interested in how he was making decisions. What is your decision-making process? What are the steps that you take when the outcomes are better what's happening what do you notice? When they're not so good what are you noticing? And just really becoming curious about how I make decisions and then obviously the context I'm make them in and the outcomes, but looking at those three pieces.

[12:30] And what was interesting was he really started to get into that towards the end of our coaching process probably about November, December time, and then of course where I guess I was most interested was how's that going to play out in real-time come January. And we had a follow-up session probably this is about March time the following year, and what was interesting was that he had been able to take that process-focused into January so that's great so there was a transference at the skill level.

[13:00] He'd also experientially noticed less anxiety, less stress as he became more focused on just making the right decision, making good decisions. Not worrying about the money as much, but really what is a good decision. How do I make as many as I can? And the most interesting thing for me, and probably for him, probably the most beneficial was that for the first time for a number of years he didn't have that stress related twitch. And I think it's just a great example of how A, it's possible to make the switch from being super results-focused to more process-focused, but also how it can really shift our experience and have such a big impact on trading decisions.

[13:50] Probably the most important thing that you can do psychologically is to probably unhook a little bit, to detach a bit from being too focused on the results and really getting curious and interested in your process. And of course, what it does mean is, is there a process, so the starting point is what are the steps that I take? What is my trading decision-making process? That's the key starting point and really thinking about that, and then becoming more curious about when you get an outcome of a trade as you will do, a win or a loss, you're not going to be able to ignore that. That's where the brains are going to get sucked into straight away for sure, but you can then switch to, "Okay, well that's interesting. What are the steps I took? How did I make that decision? What was the market context? What was my own context, my own thoughts, feelings, emotions?" And now you've got all the pieces of the puzzle and obviously also the feedback you get will be much greater and what you can do with it will be much better as well.

[14:50] My invitation to you kind of going forward from today's episode is to really start to focus more on how you make your decisions. I think at the bigger picture level really start to focus on how can I improve my decision-making process? You know almost the goal can be through your trading career to become better at making trading decisions, to become a better decision-maker, much more of a mastery type approach as opposed to being hooked too much into just those results. And again, this is probably a bit of a leap of faith, but I think if you can unhook from the short term need for results, then that focus on the process probably for most of you over time, the paradox is will actually be what brings you greater results.

[15:43] The focus of these podcasts is to help you to improve your trading performance, to become a better trader, to move closer to achieving your trading potential. Improving performance requires taking action so I'd like to invite you to take a few moments to reflect on the contents of this podcast episode. To think about what was interesting for you, what resonated and caught your attention, and to consider how you might apply it within your own trading.

[16:18] Thank you for listening to this episode of Trade at your Best. I hope you enjoyed it and found it useful. If you've got any questions or feedback about this episode or suggestions for future ones, then please get in touch through the podcast page, www.tradeatyourbest.com. This is also where you can find any links or resources mentioned in or related to this episode, and if you'd like to find out more about me and the work I do helping my trading, investing, and banking clients to perform at their best, then please visit the Performance Edge Consulting website, www.performanceedgeconsulting.co.uk