

Ask the Doc: Overcoming Market Panic

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When I was a beginning trader, I naively believed that a 100-share trade was no different from a 10,000 share one, since both could be executed with the same entries, exits, and money management. What I failed to appreciate is that the risk of any trade or investment affects our ability to evaluate it calmly, rationally, and objectively. A head of a brokerage firm, which offered free simulated trading to new traders, once told me that 80% of the traders made money in the (very realistic) simulations, but only 20% were successful once they traded real money. The difference, he observed, was the emotional impact of having actual money on the line.

In this same vein, a reader asks the Doc:

When I was younger and fitter I played soccer. My skills were okay, but I tended to panic when I possessed the ball and heard the opposition hurtling towards me.

Unfortunately I've carried this kink in my think over into my share trading.

I love trading. I've been learning and applying in earnest for the past year and have managed to overcome several barriers. However, three times I have panicked during a broad market sell off and sold out as I watched my paper profits disappear.

The latest example was yesterday. I'd struck a purple patch recently and the paper profits were looking very healthy. However, my positions began retracing without hitting my stops and those paper profits disappeared like sand slipping through my fingers.

When the market dropped yesterday, I found this too much to handle and I sold out at just above break even!

I know I won't be a good trader until I learn a few strategies to conquer these these panic attacks.

I have a few observations and suggestions for our earnest and motivated trader. But first, let me ask you—the reader—to review what he wrote and identify what *you* think is the most important thing he said. One way of doing that is to figure out what you would first ask him if you were counseling him directly. Would you inquire about:

- The soccer experience

- His emotional reaction to sell-offs
- Yesterday's market incident
- His desire to be a good trader
- Or something else?

My first question to our trader would be “something else”. I would say to him, “That’s interesting; you say you’ve managed to overcome several barriers. Could you tell me about those barriers and how you overcame them?”

Why would I ask this? Simple: *Whatever he did to overcome his earlier barriers may hold the kernel of a solution for his current dilemma.* Those solutions reflect the genuine and unique strengths of each individual. Instead of focusing on the problem and unwittingly reinforcing the notion that **he** is the problem—Note how easily he jumps from the issue of handling sell-offs to the larger, personalized problem of “I know I won’t be a good trader”—it makes sense to apply his known strengths to the challenge at hand. This reinforces the important message that *even very good traders face huge hurdles to success.*

This approach is known as solution-focused brief therapy, and it is particularly effective as a change strategy for those of us facing normal life dilemmas. Let’s say you come to me with a trading issue and I find out that you recently worked out a marital problem. You and your spouse learned to be better listeners by not taking disagreements personally and, instead, using them to identify each other’s needs and desires. Right away, we might then take a look at **how** you’ve been able to listen to your spouse and **how** you became able to not take differences personally. Perhaps this same strategy could work when it comes to listening to the market and not allowing your self-esteem to ride the market’s ups and downs!

The working assumption of the solution-focused therapist is that somewhere, at some time, each of us has successfully dealt with situations that are similar to the present dilemma. Depressed people aren’t always depressed, so how about finding out what they’re doing when they’re feeling better about themselves? Couples with problems don’t always argue; what are they doing right when they’re getting along? And our trader is not always panicking in the market, even when markets don’t always move his way. It would be worth identifying what he’s doing during those times: ***the kernels of solutions are often hidden in exceptions to problem patterns.***

As it happens, I faced a dilemma much like our trader’s early in my trading career. I became panicky whenever I increased my size, as even normal movements against my position felt too risky. I overcame that problem when I examined how I handled risk in other areas of my life. For example, whenever I tackled a new project as a psychologist, such as writing a journal article, I always made sure that there was a guaranteed home for the article before I had finished it. I did this by consulting with editors ahead of the writing. My logic was that, by securing my publication, I could free myself to focus on the process of writing.

Similarly with trading, I learned to take guaranteed profits when positions went my way. Once a trade moved in my favor by the amount I was willing to risk on the trade, I immediately created a trailing stop on the position that guaranteed a profit. As a result, a winning trade could never become a loser. As the position moved in my favor, the stop moved with it, locking in an increasing profit. The security of knowing, “This trade will be a winner, no matter what” provided the reassurance I needed to counteract fears of risk. In my work with high frequency traders, I’ve used the same rationale to create trailing stops on *daily* profit/loss, so that, once the trader is up by a certain amount of money during the day, the stop point for the trading session is moved to a level of assured profitability.

My solution may not be yours; the beauty of solution-focused counseling is that it allows each person to craft solutions based on *their* experience—not the abstract advice of a guru. If you can identify the occasions when you’re *already* a good trader, the chances are good that an analysis of those occasions will start you on the road toward solving the next market challenge.

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