

FEAR AND TRADING

Partly based on

Your Money and your Brain

Jason Zweig –Souvenir Press 2007

Neither a man nor a crowd nor a nation can be trusted to act humanely or think sanely under the influence of a great fear To conquer fear is the beginning of wisdom.

- Bertrand Russell

Often most afraid of the least likely dangers while paying little attention to dangers much more likely to eventuate.

Airplane travel versus car travel.....

Consequences versus probability....

More worried about danger of a market crash than about the damage done by inflation

.... or the damage done by our own lack of discipline

.... or the damage caused by excessive brokerage

Emotions override rational thought

Read story of home invasion and
become afraid of being home alone
at night

Intuitive sense of risk driven by
'dread' and 'knowability'

Dread defined by:

How vivid,

How controllable,

How potentially catastrophic.

‘Knowability’ defined by:

How immediate,

How specific,

How certain.

These combine to twist perceptions:

Underestimate when we feel in charge
and understand the consequences

Overestimate when uncontrollable and
less comprehensible

Amygdala deep inside the brain, two parts, left and right

Involved in 'emotional intelligence'

Daniel Goleman – 'amygdala hijack'

An 'amygdala hijack' exhibits three signs: strong emotional reaction, sudden onset, and post-episode realization that the reaction was inappropriate.

This kind of reaction can be the most risky thing an investor can do

Fearful face pictures flashed on screen for 1/30 second primed the amygdala for fear response.

A frightening word flashed on a screen for 0.012 second caused fear response.

We can be affected by fear even when we don't know we are.

Even language – use of certain words – can inspire fear.

So stress hormones can be released unknown to us.

Strategies:

Write down the reasons for deciding since this will dampen the fear response.

Set stops and stick to them. Realize that the occasional greater than 1R loss is inevitable.

Strategies:

Tighten stops in volatile markets and be prepared to re-enter on buy signals once the market settles

Be aware of what fear can do and act to reduce the effects (take a break, get some exercise etc.)

Strategies:

Be careful of reading predictive material and online forums etc – fear is contagious and herd mentality is irrational.

Use a trading plan that you know works and follow it to the letter.

Strategies:

Keep a trading diary – include your moods as you trade. You will likely find that you should use your moods as reverse indicators.

Trading plans designed to be most 'comfortable' may not be best.

Strategies:

Understand that as a private trader you are more nimble and can go to cash very quickly.

Possibly try such techniques as meditation that have been shown to have a beneficial effect on the amygdala.

Strategies:

Remember Bertrand Russel:

To conquer fear is the beginning of
wisdom.