Why Traders Plan Trades But Don't Trade Their Plans

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Consider the following advice:

* *Trade what you see;*

* *Trade the plan, and plan the trade;*

* *Don't let emotions interfere with trading;*

* *Don't overthink trades; go with your feel for the market.*

All of these are reasonable in themselves, but they also contradict one another. Should you shut off your emotions or go with your feel for the market? Should you stick with your trading plans or get in/out of the market when you see an unexpected development?

If you read my last post, you can see that the reason for the contradictions is that the advice pertains to different time frames. The very short term trader--the scalper or market maker--can't afford to overthink trades. He or she also can't afford the luxury of a well laid-out trading plan. Rather, that trader needs to become so familiar with short-term trading patterns that he/she embeds them in perception itself. Instead of seeing 2400 contracts at the bid and 800 at the offer, for instance, the trader sees a pattern of growing contracts at the bid as the market repeatedly--but unsuccessfully--attempts to penetrate that bid price. That pattern in the order book, occurring in the context of a market that has already declined by 1-2 ES points, might well signify to the scalper that a short-term bottom is forming and lead to a quick trade for a few ticks once short covering occurs.

Conversely, the longer-term trader might develop an idea that the market is weakening over the past several days and that we're likely, in today's market, to take out yesterday's low price. The trader waits for early trade to confirm that buying is unable to take the market above its overnight high and then sells the market. A couple of ticks above the overnight high is the stop loss point, a couple of ticks below the previous day's low is the profit target for the first half of the position, and then the trader sits back and lets the trade work out. That's planning the trade and trading the plan, taking the emotion of moment-to-moment trade--for the most part--out of the equation.

What is good trading in the first mode--getting out, say, if large trades occur at the bid--would be getting scared out of a trade plan in the second mode.

What is signal to the short-term trader is noise to the longer timeframe participant. That is why traders feel as though they sabotage themselves when they put the trade on in one mode (by feel or by explicit plan), but then manage the trade in the different mode.

So here's a good question: If you do truly trade a plan, what percentage of your exits have you out: a) at your price target; b) at your stop loss; c) somewhere between the two. *If a large proportion of exits qualify for option c), then there is a good likelihood that you're managing the trade by feel and not by your plan.* While there are occasions in which that can minimize losses and lock in gains, over time--***if your plan is a solid one***--you will tend to take yourself out of trades with small losses that ultimately could have been winners, and you will tend to cut winners short of their potential.

Notice what I'm saying: ***If you are managing your planned trade more often by feel than by plan, you are expressing--through your behavior--a lack of confidence in that plan***. If the plan is solid, it should be worth following more often than not. If you're frequently not managing the trade the way you put it on, you're using short-term criteria to bail out of the plan (i.e., weighting short-term criteria more highly than plan criteria).

Now there could be all sorts of reasons for this. It could be a plain vanilla anxiety problem that could benefit from behavioral techniques, such as relaxation training and biofeedback. It could be faulty planning: perhaps position sizing is too large or stop loss points are too far away for your personal level of risk or account size. It could also be that you're trying to trade a longer time frame, when your cognitive skills and style better suit you to a shorter one. Too, traders often bail out of plans when they have not had sufficient first-hand experience with those plans and thus naturally lack confidence. This often occurs when you try to trade someone else's plan/setup without having researched or practiced it extensively yourself.

My general advice is to practice the behavioral methods, cut your size considerably (perhaps even going into simulation trading mode), and then religiously follow your plan trade after trade after trade. That will tell you if the plan truly suits you, and it will also give you the first hand realization that the plan is worth following. You can't expect yourself to tune out noise on the short timeframe unless you have a high degree of conviction in what you see and plan in the larger picture.

But here's a second exercise--one that I've adapted from Linda Raschke--that can be very helpful in dealing with information processing challenges in trading. Select a time frame to practice. You can do this by trading in simulation mode and setting your charts to 1 minute, 5 minute, 15 minute, 30 minute, or 60 minute bars. ***You have to stick with the setting you choose throughout the trading session***. No toggling to shorter or longer time frames. Then set your alarm clock for a random time in the next few minutes. When the alarm rings, you have to enter the market within the next bar period (i.e., if you're trading 5 min bars, you must enter in the next five minutes). You can either sell or buy the market, but you have to enter, and you have to manage the trade at your chosen time frame. Moreover, you have to hold your trade for at least one entire bar period (i.e., if you're looking at 5 minute bars, you hold for at least 5 minutes, etc.), but no more than two. *That means being prepared, in advance, with support/resistance levels or indicator levels that can serve as stops and as profit targets.*

Reset your alarm for another random time in the near future once you exit a trade until the day's trade is complete. This will have you trading much more actively if you're trading 1 min or 5 min bars than if you're trading 30 min or hourly bars.

Make sure you trade each time setting (the 1 min, 5 min, etc bars) many times over many days. Force yourself to perceive/plan, enter, manage, and exit trades like a short-term trader and like a longer-term one. Feel free to look at whatever news, indicators, or other data you ordinarily consider during trading, as long as the data are not derived from shorter-term bars than the ones you're trading. Over time, what you'll find out is the kind of trading--and hence the kind of information processing--that you're best at and that is most comfortable for you. Are you best and most at ease when making fewer trades and planning these in detail? Are you in your element when you're reading short-term patterns from minute to minute? Which feels most natural for you? Which keeps you in your "zone"?

Traders rarely have subconscious desire to sabotage themselves. *We do ourselves in when we don't truly know who we are, what we're best at, and thus what would provide us with the greatest degree of conviction and confidence.*