

Market Psychology

Have you ever wondered why traders take on a position or why the prices move? Have you ever wondered how the human psychology plays a part in the marketplace? All actions taken by traders are based on some part of their psychology. Whether it is greed or fear or just hope, they take action based on their feelings at the time of their trade. In this article, we will investigate the feelings behind these actions.

One key factor in the psychology of trading is this – we all hate being wrong. This does not come naturally. We have seen babies try and try again to stand up, or to speak and so on. They do not hate being wrong. So how does this come about? The fear or hate of being wrong came about during our growing up years, and it does not stop there. We are taught to try to be right always by our parents, teachers and even peers. When a child commits a mistake at home, most parents would reprimand the child. When a child makes a mistake in school, he is most probably shamed in class. When a man makes a mistake in his work, he might get the sack. With all these social influences, we have grown pretty much afraid of being wrong.

We also know that when a trader places a trade, he thinks that he is right and he is going to make money. But if the price goes against him, there are 2 kinds of pain that he has to accept. One is to accept that he is wrong, which as we discussed earlier, is a great deal of pain to take. The other is to accept his losses and close his position. So the common trader would prefer to take his losses until the pain of losing money becomes greater than the shame of being wrong. When this happens, it is usually a great deal of money lost.

Another type of negative emotion associated with the common trader is the fear of losing out. We all fear that we lose out on an opportunity. When we see others get a large reward doing something that we could have thought of but that which we did not do, we get some negative feeling – jealousy. This is the same in trading. We fear that we are wrong, and in return, we fear that we are right too! This is apparent when we are to exit a position and to cut our losses. What if the price rises after we've closed our long position? It is worse if we sit in front of the charts and we see that the price really did go up 3 bars after.

We want to avoid these kinds of beliefs and at the same time, bear it in mind that other traders are feeling the same too.