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Trading Psychology and Risk Management

FOREX TRADING PSYCHOLOGY

Anyone can learn about indicators, charts, analysis and strategies and they might be moderately successful for a short term. However, if you are going to have long-term success trading forex you must understand the psychology behind the decisions you make.

You must learn to control your emotions while you are trading because emotions get in the way of rational decision-making. First, once you set your rules of trading and create your trading plan you cannot break your own rules. You will find yourself getting excited, scared, hopeful or uncertain at some points during the trading process and it can be easy to throw your plan out the window and break your rules.

You must have the self-discipline to stay with your plan if you want to be successful. You are going to lose money at times, but you cannot let those losses make you afraid to take advantage of another opportunities.
Excitement can lead to greed, which is an emotion that can also cause you to break your rules. You must be objective about your trading system so that you exit a trade even when you think you could make more by breaking your rules. Be satisfied with what you have. Follow your plan and move on to another trade.

The other emotion that can wreak havoc on your trades is hope. Many traders hope that they can make their money back by staying with a trade long after it should have been exited. If one of your trades goes wrong, the prudent action is to get out of it sooner rather than later. Hope is not based on any reasonable analysis and can lead to bigger losses over time.

Self-discipline is the single best quality a trader can have. You must be able to walk away from trades that aren't profitable or from trades where the maximum profit has been reached.

MASTERING RISK MANAGEMENT

Risk management is essential in forex trading. You must take the steps to minimize your losses. You are going to lose on some trades, and possibly on many, however, your goal is to use strategies to prevent continuous loss so that you still have capital to continue trading.

Stop-loss orders are critical to controlling risk. Most trading experts advise that you enter a stop-loss order for every open trade you have. This allows you to exit the trade if it starts to go against you. Novice traders are often overly worried about losing trades, so they don't exit early enough to keep from incurring more loss. They simply hope that the market will reverse, and their losses will be wiped out.

As mentioned earlier, “hope” is not a strategy. Stop-loss orders will keep you from hoping too much. Before you ever get into a trade, you need to determine how much of your initial investment you can afford to lose if your trade turns on you. This will allow you to remove emotion from your trade.

If your losses reach your predetermined account, you can get out of the trade without feeling like you lost more than you could afford to.

You must also continually evaluate your trading strategy, especially if your current strategy does not appear to be working. When you place your stop-loss orders and your limit orders, you must decide how much loss is too much and how much profit is enough. You should not place your orders too close to the normal market price though, because any little fluctuation could trigger one of them. However, you don’t want to place them too far from the norm either, since the further away you get, the more risk you are taking.