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Psychology of Trading

How successful traders think, and what they can learn from chess, sport, and the battlefield

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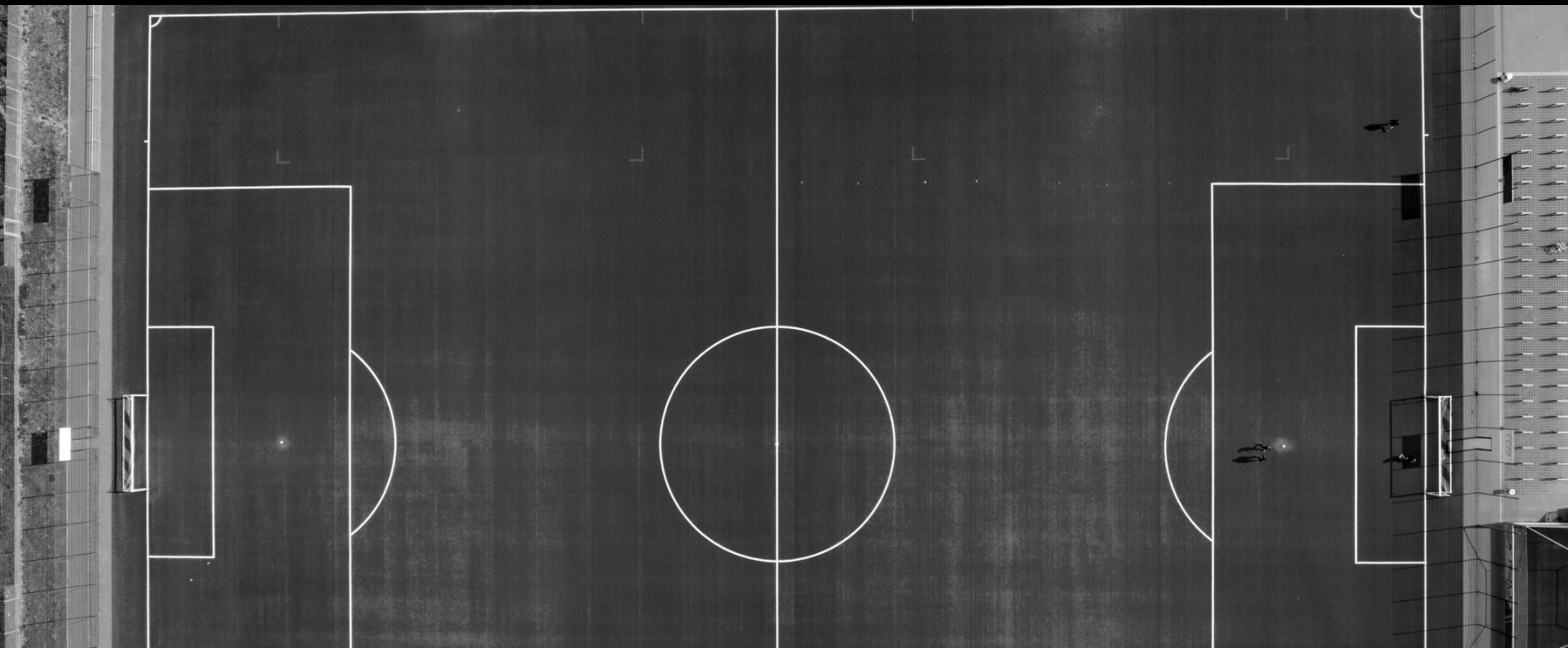


Executive summary

The market has its ups and down: bull runs can come to a crashing end, stock prices can unexpectedly pop and unforeseen events can leave the best laid plans in ruins. But despite the ups and downs, the best traders find a way to thrive whatever the environment throws at them.

Much of this is down to psychology. Top traders know how to maintain the right state of mind and keep a check on their emotions in stressful situations. In this report we examine the psychology of trading and the realities of making decisions under high-pressure, psychologically intense conditions.

To do this, we have surveyed a wide range of successful day traders and interviewed a host of experts from outside of the world of finance, including a chess grandmaster, a football referee and a military strategist, for their tips on making the right move when the clock is ticking.

Psychology of Trading

The thrill of the trade

Psychology of Trading

Back at the turn of the millennium, scientists from Stanford University signed up 14 volunteers to have their brains scanned as they completed tasks where they could win or lose small amounts of money based on how well they performed.

Traditionally, economics had always assumed that humans only derive pleasure from money based on what they can buy with it.

But what Brian Knutson and Richard Peterson at Stanford found was that when the volunteers won money, the pleasure centres of the brain were activated. The same areas of the brain were lit up by the task, which in many ways mimics trading, as when a person sees a beautiful face.

"Why is trading so exciting? It is partly because of the way our brains are wired."

We may like to think that trading is a wholly rational experience where we calmly evaluate positions, but many of us know that trading can be an emotional rollercoaster. It can be exciting, boring, anxiety inducing but most of all when it is going right, it can be immensely fun.

A survey of 150 traders by Exness found that nearly half (45%) of respondents said that they felt excited while they were trading, while just over a third (35%) said that they felt pleasure from their trading activities.

45%

of respondents said that they felt excited while they were trading

31%

said they felt negative emotions when they traded - frustration, self doubt or even fear

"You're only as good as your next game"

Keith Hackett, former English Premier League football referee on decision making under pressure

Insight from
Keith Hackett

Keith Hackett is a former English football referee who oversaw some of the biggest games of English football in the 1980s and early 90s. Much like trading, Hackett says the thrill and excitement of the job comes from the element of risk involved.

"You're only as good as your next game. Not the one that's gone," says Hackett, who points out that there is the constant potential to make a game changing mistake that may be watched by millions.

He says to cope with that, referees need to be calm, confident and master their emotions - traits that can only be fostered through experience and a willingness to learn from mistakes.

"The very good referees make fewer mistakes, it's as simple as that," he says. "The main thing is concentration. You look at the very top referees and they're confident they have a calmness about them."

But let's not ignore the lows. Nearly a fifth (19%) of respondents said they felt bored when they traded. Similarly nearly a third (31%) said they felt negative emotions when they traded - frustration, self doubt or even fear. This was particularly true for respondents who relied on trading for a bigger slice of their income, most likely because it was more stressful having the pressure of relying on trading to pay the bills, rather than simply dabbling in the markets.

Why is trading so exciting? It is partly because of the way our brains are wired. We get a hit of dopamine when our trades are on the up. The fact that our brains only periodically get that jolt of dopamine, combined with the risk that it could all go wrong, makes it doubly intoxicating for the brain. It is the same reason why top football strikers keep on playing even if they are having a dry patch - the jolt of pleasure of the ball hitting the back of a net can make up for months of not scoring.

"If you want to progress, you have to try to control your emotions"

Our emotions can play havoc with the way we trade, making us act impulsively, hesitate or cash out at the wrong time. Recognising the effect that our emotions have on how we trade is a key part of the job.

Anastasiya Karlovich is a chess grandmaster who teaches her students to recognise their emotions during matches, so they can let them go and focus on the game.

"If you want to progress, you have to try to control your emotions", she says. "We try to recognise our emotions and accept them. It can be a big fight with yourself to calm yourself down and focus on the moves."

The art of decision making: Three ways to be a better trader

1. Know your mission

When it comes to making good decisions under pressure, having a plan is crucial.

Yet it is surprisingly common for day traders to act on impulse. Nearly a third (34%) of respondents to a survey of traders by Exness said they sometimes made quick decisions without planning or proper analysis.

Robert Kershaw, a former paratrooper and military historian, says that soldiers are taught to understand their mission and what to do if things go wrong.

He says: "You get the basic mission, you know what it is you have to achieve. But once you get going, it might start raining or snowing. Then you've got to reassess your original task and say to yourself, `what impact do these changed conditions have upon what it is I'm required to do?"

In trading, that means understanding why you are trading, what you hope to get out of it and what you will do if conditions change. Are you trading for fun? To make a certain return? To learn?

For example, if you are trading to learn and do not mind being in a neutral position, you could introduce stop losses, do in depth research on a limited range of companies and use back testing software to test how your trades would have done.

Having a plan also means you can do more technical analysis, the number one resource for traders who make over half their income from trading.

2. Take a break

Good decision makers can have off days. When Norwegian chess grandmaster Magnus Carlsen is on a losing streak he is known to take a novel approach to halt his losing run. Instead of burying his head deeper in chess, he goes ten pin bowling. Carlsen's approach is a useful lesson for traders: sometimes taking a step back can help us regain our composure and approach a problem with a fresh perspective.

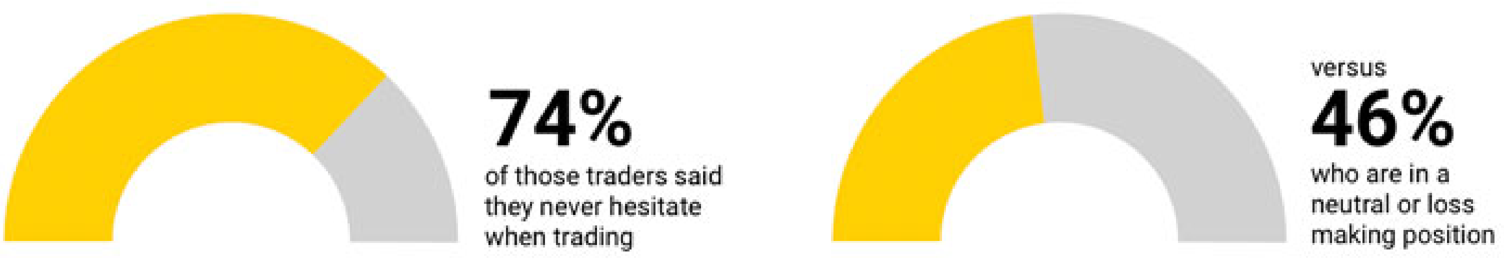
That could be taking time out to do yoga, listen to heavy metal, play video games, eat cheesecake, talk to a friend or read a book - whatever works for you.

When it is not possible to take a break during a losing streak, Anastasiya Karlovich, a chess grandmaster, recommends changing your approach and aiming for a draw rather than a big win. That means steadying the nerves and playing slowly and carefully for a sensible result.

Karlovich says: "Stop the blood flow. Make a draw. Try to play carefully without risk."

> "When it comes to making good decisions under pressure, having a plan and sticking to it is crucial"

Decisiveness is important



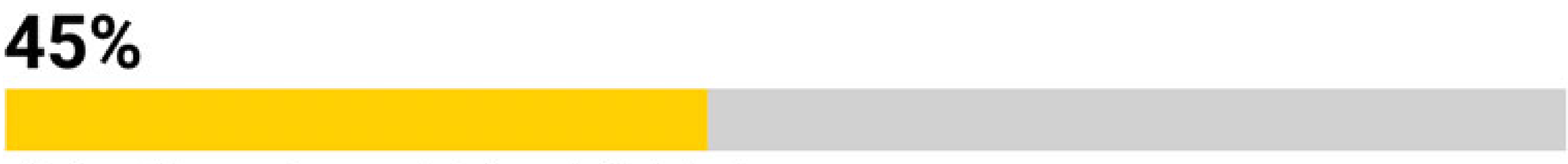
3. Focus

Focus is crucial to making good decisions under pressure. That can be easier said than done: 45% of traders said they sometimes cannot stay focused while day trading.

But maintaining focus enables traders to make quick decisions at crucial moments. Over two thirds (68%) of traders who rate their ability highly say they never hesitate. While day traders who earn over half their income from trading also say that decisiveness is important: 74% of those traders said they never hesitate, versus 46% who are in a neutral or loss making position.

A key way to do this is to acknowledge emotions and let them go, so that you can refocus on the moment. Kershaw says that on the battlefield soldiers need to distance themselves from whatever they are encountering.

"You need to distance yourself from the pell mell nature of conflict. You sit above it and stare at it, rather than become emotionally entangled in it", he says. "Don't feel sorry for the enemy. Don't feel sorry for yourself. Be as dispassionate as possible in order to achieve the aim."



of traders said they sometimes cannot stay focused while day trading

The trading boom

If you ask the man on the street to describe a trader, they will probably conjure up an image of an arrogant twenty something in a pinstripe suit who is convinced of his own brilliance.

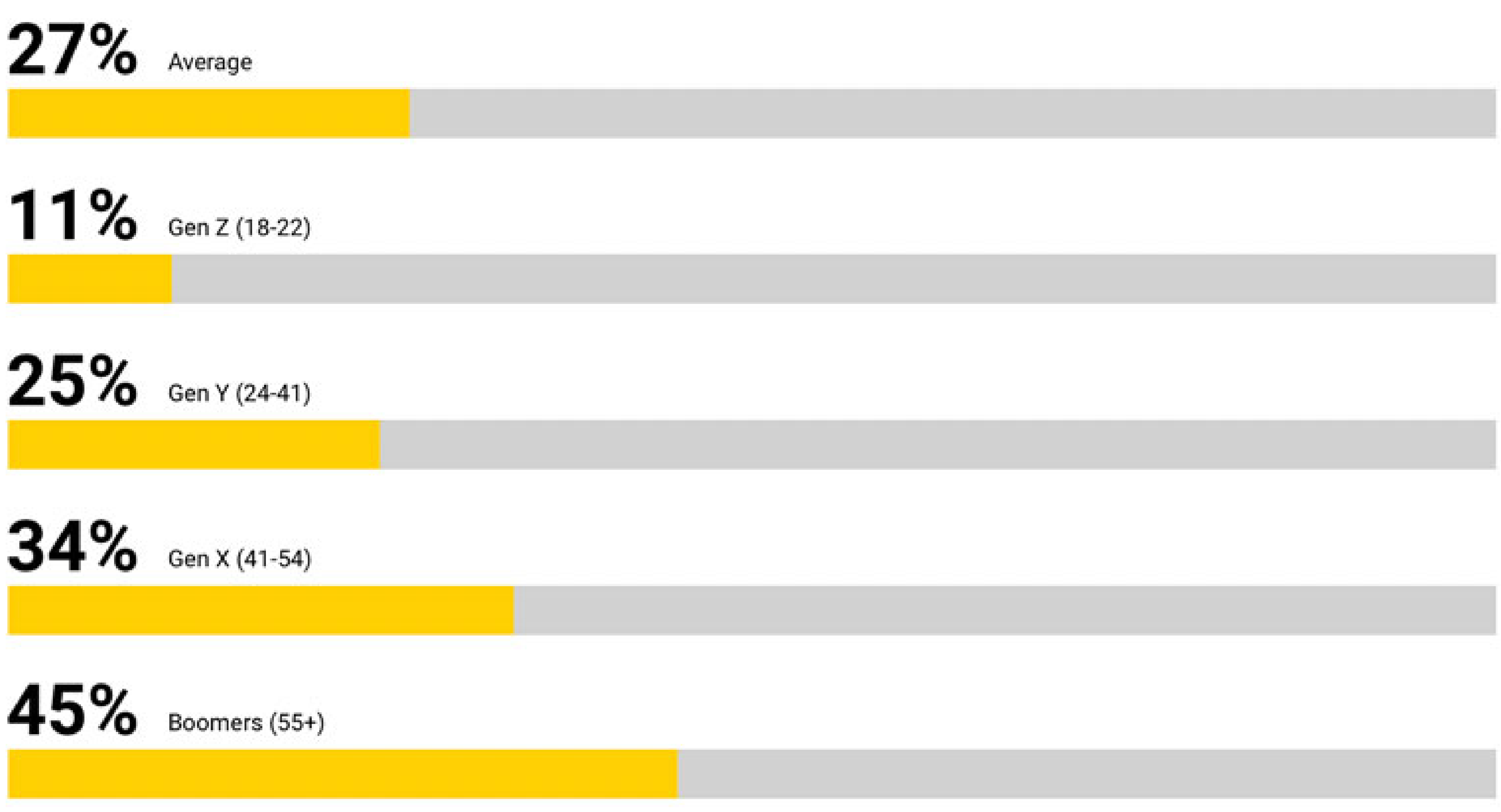
But that image of the coolly self assured young person is far from the truth, because when it comes to trading, age breeds confidence.

A survey by Exness found that the older you get, the more confident you are with your trading abilities. Day traders aged 55 and over are much more self assured than their younger counterparts, with 45% saying that they are confident in their trading abilities compared to just 11% of Gen Z respondents, 25% of Millennials and 34% of Gen X respondents.

"When it comes to trading, age breeds confidence"

When we interrogate the data further, we see that older traders generally exhibit cooler and calmer trading behaviour. Those aged 55 and over are more likely to close their trades early, know when to close manually, don't hesitate and show the most patience in holding onto losing positions for longer.

Confident traders



"Confidence comes through experience"

Keith Hackett, former English Premier League football referee believes age breeds experience

Insight from
Keith Hackett

Keith Hackett, former top-level football referee, agrees that age breeds experience.

He points out that by the time a referee joins the Premier League he will likely have spent ten years honing his skills in lower leagues - a crucial period for him to make mistakes and gain the level of confidence needed to cope in the big leagues.

"I think a great referee takes risks" he says. "The more experienced referee is likely to have experienced conflict to a greater level, therefore he has the ability to take greater risks. Because he says to himself 'I'm in control. I don't have a problem'".

Those risks could be giving a verbal warning to a player rather than a yellow card, or even allowing the match to continue after a foul if the the team that was fouled has possession.

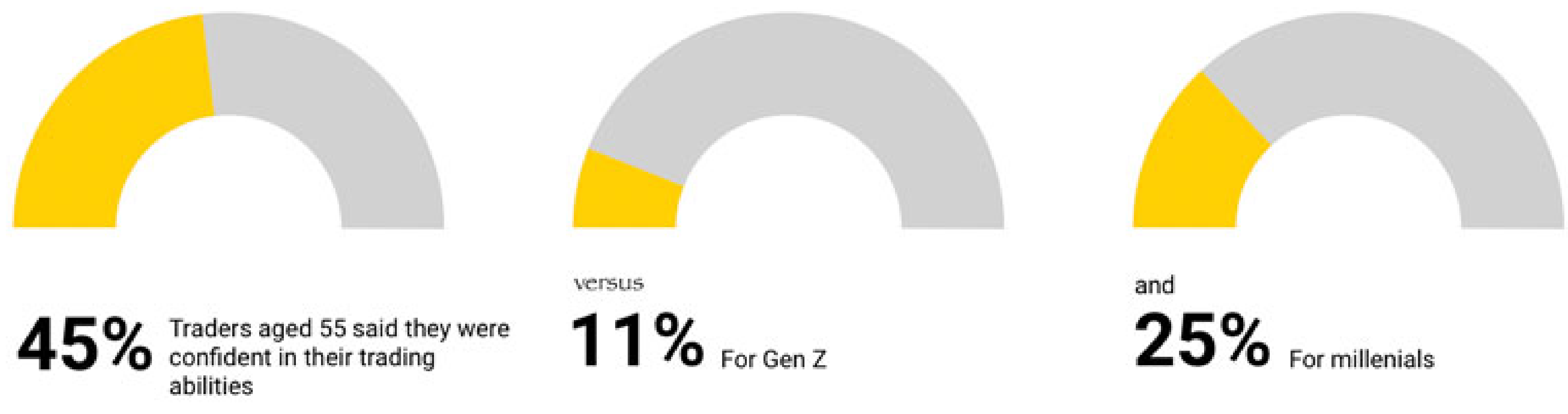
"The confidence comes through experience. These are absolute measured risks. That process helps you reduce conflict and your actions have actually added positive response," he says.

But he cautions that confidence can "easily trip into arrogance" and experienced practitioners need to make sure they are always learning.

Part of this is down to experience. Older traders are more likely to have racked up years of practice, making mistakes and learning from them along the way.

Robert Kershaw, a former paratrooper and military historian, said that gaining experience by doing a range of roles is critical to shaping good judgement.

He says: "The reason [top military staff] have excellent judgment is because they've done all the jobs along the way. If you've got somebody who's been immersed in the field with which he has decided to become an expert, his judgment will be pretty good by the time he is nearing the top."



But it may not just be experience that fosters confidence in older traders. Baby boomers tend to trade for different reasons than their younger counterparts.

Nearly three quarters (73%) said they traded for the intellectual challenge and to up-skill their financial abilities (64%). Whereas younger cohorts were more likely to trade to be their own boss (63% of Gen Z respondents) or to earn more money than as a traditional employee (55% of Millennial respondents).

Those different reasons for trading may affect how different age groups think and approach trading. There is less at stake for older traders who are trading for the thrill of learning than for nervous youngsters who are trading to pay the mortgage or finally give up that job they hate.

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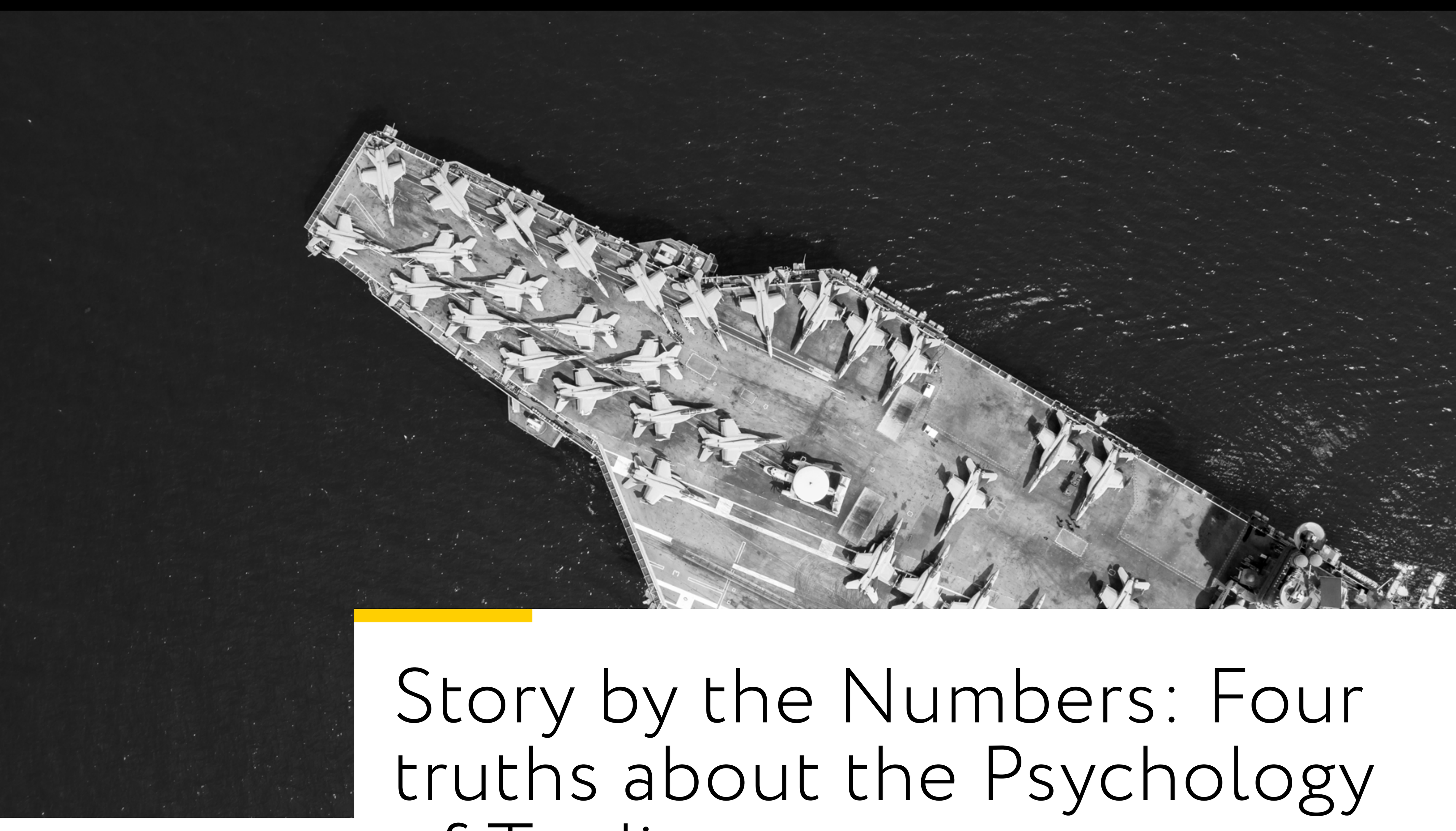


Story by the Numbers: Four truths about the Psychology of Trading

Why do traders trade? Above all else, it's about excitement and pleasure.

Why do traders trade? Above all else, it's about excitement and pleasure.

74%

of traders who make over half their income derive pleasure from trading

9% Fear

11% Self doubt

35% Pleasure

19% Boredom

45% Excitement

11% Frustration

3% None of the above

How to be a better trader? Have a plan, take regular breaks and stay focused

79%

of traders who have neutral or loss-making positions make quick and less informed decisions

Having a plan also means you can do more technical analysis, the number one resource for traders who make over half their income from trading

31.10%
My instinct

35.79%
Fundamental analysis e.g. news events, economic indicators, stocks revenue, valuation, or industry trends

33.11%
Technical analysis, historical data e.g. price and volume

When it comes to trading, age and experience breeds confidence

45%

of day traders aged 55 and over say that they are confident in their trading abilities compared to just 11% of Gen Z, 25% of Millennials and 34% of Gen X respondents.

27% Average

11% Gen Z (18-22)

25% Gen Y (24-41)

34% Gen X (41-54)

45% Boomers (55+)

55+

year olds are more likely to close their trades early, know when to close manually, don't hesitate and show the most patience in holding onto losing positions for longer

19% Average

21% Gen Z (18-22)

22% Gen Y (24-41)

6% Gen X (41-54)

36% Boomers (55+)

Social media is fertile ground for insight... But don't believe everything you read

Social media is the most used source of information for Millennial and Gen Z day traders

51%
of Millennials regularly use sites like Facebook, Twitter and Reddit

74%
of Gen Z traders regularly use sites like Facebook, Twitter and Reddit

However, the quality of information from Social Media can be poor

83%

of traders who made no profit or were in a losing position on their trades used social media

How and where are traders gaining insight?

Tehnical analysis 50%

Social media including Twitter and Facebook 47%

News wires such as Reuters and Bloomberg 44%

Copy day trading (social day trading) 43%

Algorithmic day trading 43%

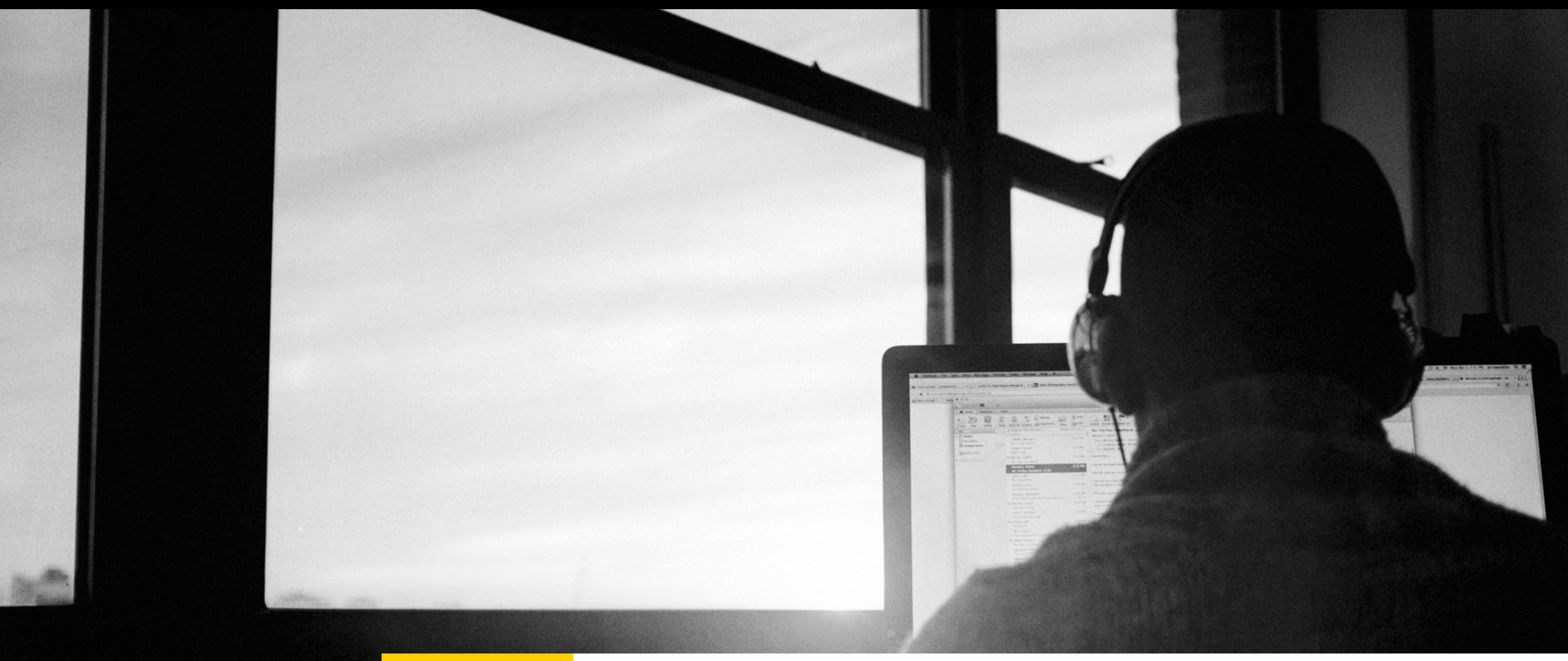
Broker integrations 40%

Company sources such as annual reports 39%

Backtesting sofrtware 30%

Genetic and neural applications 29%

#1 resource for traders that make half income through trading is technical analysis



Rise of the social media trader

Psychology of Trading

When the share price of GameStop exploded in January, many in the financial press were confused. Why were these traders getting their information from Reddit and not the Wall Street Journal or Financial Times?

But for many day traders social media has long been a valuable and free source of trading insight.

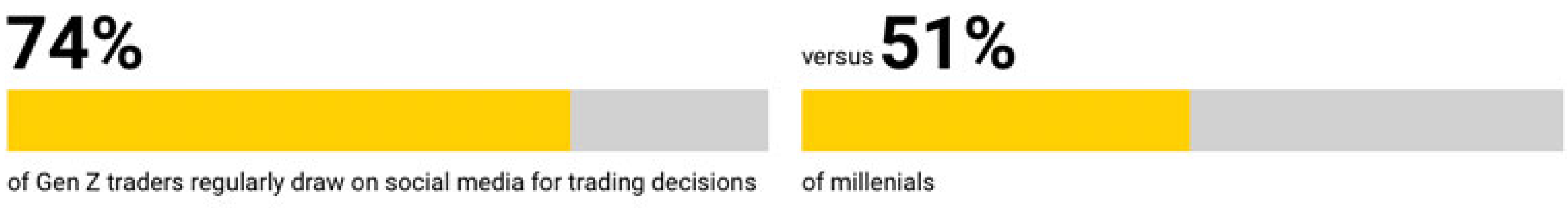
A survey for Exness found that social media was the most used source of information for Millennial and Gen Z day traders, with over half (51%) of Millennials and three quarters (74%) of Gen Z traders regularly using sites like Facebook, Twitter and Reddit.

Social media trumped newswires (used by 47% of Millennials) and company reports (used by 40% of Millennials) for its usage.

> "Back in the early 2000s, it was Yahoo Finance. Nowadays it is Reddit, YouTube, Clubhouse, Slack and Whattsapp"

There can be big benefits to investors in using social media. As well as demystifying the markets for small scale investors, it provides rookies with opportunities to learn and gain support from more experienced traders. All without having to go on a course or subscribe to expensive news services.

Take a recent Reddit thread where a poster asked "What do you think is the easiest way to educate yourself in how to make profitable trades?". The post yielded all sorts of helpful advice from backtesting trades, using simulated accounts and starting off with small bets to learn the ropes.



One person replied: "Reddit and YouTube taught me. Trading real money and learning how to control my emotions has been my biggest lesson. When things go bad don't get discouraged. Good luck on your journey. I believe in you."

Trading with help from social media is also seen as a way of 'sticking it to the man', an anti establishment way for regular folks to make money in a way that has traditionally only been open for Wall Street types.

When one trading platform halted trading in GameStop and a number of other stocks in early 2021, one redditer posted: "THEY ARE TRYING TO SHUT US DOWN! YES, it is rigged! We have them shaking in their boots. But we are larger and united."

> "Trading with help from social media is also seen as a way of 'sticking it to the man"

While social media may be easy and free to access - particularly useful for traders who are just beginning to hone their skills - the quality of information on specific trades can be poor. Influencers can also overhype certain trades or strategies because they are hoping to make a profit on that strategy. The Exness survey found that over four fifths (83%) of traders who made no profit or were in a losing position on their trades used social media.

We saw this play out with GameStop and other memestocks. While many Redditers made big money from the rollercoaster ride, others lost their savings. One North Carolina fish farmer told Forbes that he lost over $20,000 of his savings by betting on GameStop options, despite his trades being $300,000 up at one point.

So it pays for day traders to critically assess the value of social media and use additional information to confirm whether the information is useful. That could be using technical analysis tools, such as Bollinger Bands or Exponential Moving Averages, which are the number one used resource for traders that trade over 50% of their income.

Or backtesting software, which simulates how a trade would perform - rarely used by younger traders, with just 11% of Gen Z traders and a quarter (26%) of Millennials using the software.

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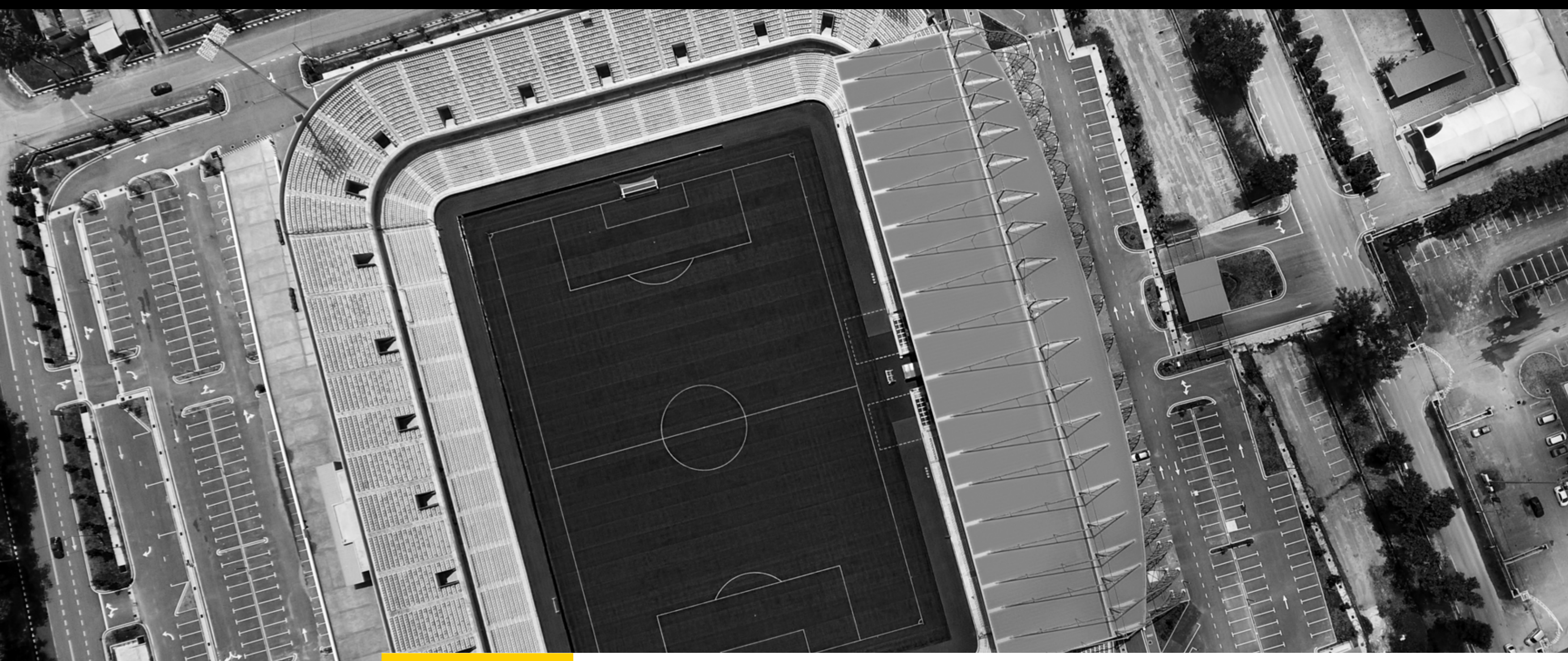


New kids on the block

Psychology of Trading

Bread-making, gardening, playing the Last of Us Part II. The pandemic got many of us to take up new hobbies to pass the time.

But it also got many young people into a potentially more lucrative hobby: day trading.

Stuck at home with a flexible schedule and perhaps a bit of extra cash from not going out, many Gen Z'ers decided to dabble in the markets.

This should not be too surprising. Gen Z, who are aged 18-22 years old, are known to be an entrepreneurial lot. Online platforms like Depop, Fiverr and Etsy have made it easy for this cohort to earn some extra cash through a side hustle and the proliferation of mobile trading apps means it is easier than ever to start day trading.

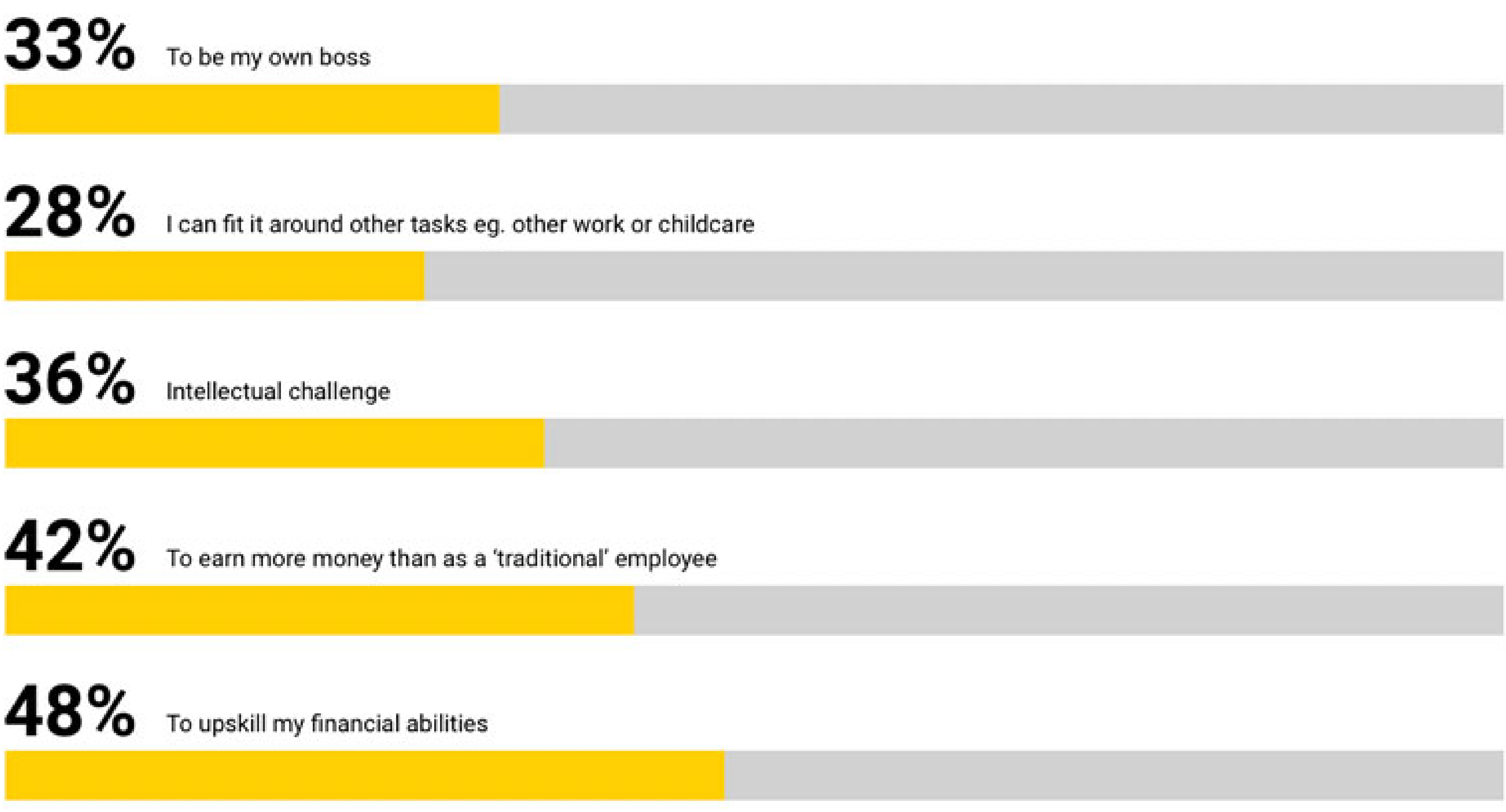
We see that in the data. This group trade mainly through mobile, with nearly three quarters (79%) of Gen Z respondents saying they traded through apps, compared to just a third (37%) of all respondents.

But while Gen Z may be keen to earn some extra cash, they aren't just in it for the money.

Day traders aged 18 to 22 years typically trade because they want to be their own boss, with nearly two thirds (63%) of Gen Z respondents saying that striking out alone was their main reason for trading. Just 11% said they were trading to earn more money than as a traditional employee.

In the long term, this may play to this generation's advantage.

Reason for trading



Chess grand master Anastasiya Karlovich believes that leading players typically put money out of their mind when they play.

"I believe that top players in genera"It puts more pressure. When you are thinking: 'This move could cost $50,000', it can be destructive," she says, adding that thinking about money can take your head out of the game and stop you focusing on the moves in front of you.

But she says that this is easier for top players to do as they already have financial security, gained through years of winning competitions.
I are a bit more relaxed [about the money]. All of them pretend the result is more important than money," she says.
can bring, trading is not without its risks and it isn't proving to be as profitable as they may have hoped.

Over half (53%) of Gen Z respondents said they had made no profit or even lost money over the past six months of trading. This is over three times higher than the generation above them, with just 15% of Millennials saying they made no profit or lost money in the past six months.This may be because younger traders are more likely to make riskier bets. Research by the UK's Financial Conduct Authority found that many younger investors went f

When we interrogate the data further, we see that while Gen Z may be excited about the lifestyle that trading
or "high risk high return" investments, such as crypto currencies.

That lack of success is also feeding through into their confidence levels, just 11% said they were confident in their trading abilities, compared to a quarter of Millennials and 45% of baby boomers. They are more likely to trade impulsively, with 58% saying they sometimes make quick decisions without planning or proper analysis. While a quarter (26%) say they often hesitate.

Gen Z also finds it harder to get money to trade with. Lack of capital was the number one barrier to trading for this group and nearly half (47%) said they used "as much leverage as possible" when trading, compared to 16% of all respondents.

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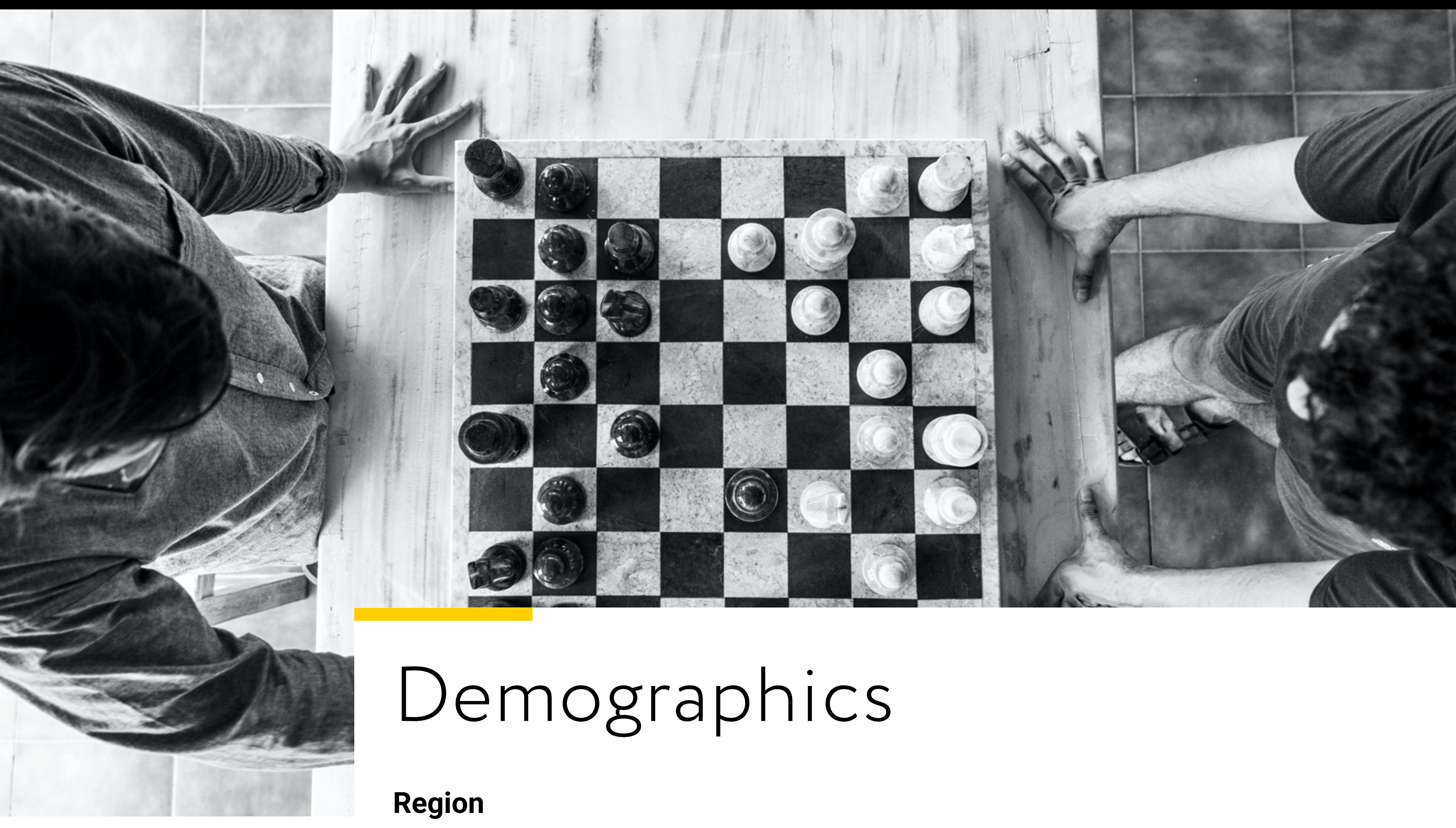

Demographics

Region

33% EMEA

33% APAC

33% LATAM

Region

33% EMEA

33% APAC

33% LATAM

Region

33% EMEA

33% APAC

33% LATAM

Average notional trade

60% $100-$1,000

30% $1,001-$10,000

10% $10,001+

Trading pattern(s)

100% Buy and sell in single day

51% Trade short-term (upto 2 day hold)

60% Trade mid-term (hold for weeks)

40% Trade long-term (hold months/years)

Age

13% Gen Z (18-22)

59% Gen Y (24-41)

21% Gen X (41-54)

7% Boomers (55+)

Capital split

80% Own funds

46% Friends and family funds

45% Company funds

Proportion of income from trading

15% More than 50%

37% 20%-50%

32% Less than 20%

Trading tenure

16% 6-12 months

27% 1-2 years

19% 3-5 years

38% 5+ years

Trade type

49% FX (including FX CFDs)

54% Equity indices (inc. ETFs/index futures/index CFDs)

43% Individual equities (inc. equity options/equity CFDs)

45% Commodities

47% Bonds and bond futures including gilts/treasuries

37% Cryptocurrencies