EMOTIONAL MANAGEMENT FOR THE LONG HAUL
Today’s Focus

➢ NOT probabilistic thinking — we’ve drilled this point home again and again
➢ We’re going to focus on handling emotions over the long haul
➢ How does one endure the ups and downs of trading over a 5-10 period?
➢ A string of losers, or a multi-month/multi-year slump can be extremely taxing and cause burn out
➢ You need systems and processes in place to push through the tough times and come out healthy on the other side
The Harsh Reality of Trading

➢ You will spend most of your career in a drawdown
➢ A few of those drawdowns will test your will to continue

Are you still in the game?

S&P 500 Historical Drawdowns: 1927-2016
<table>
<thead>
<tr>
<th>Period</th>
<th>Loss in Berkshire Stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 1973 to January 1975</td>
<td>59.1%</td>
</tr>
<tr>
<td>Oct. 2-27, 1987</td>
<td>37.1%</td>
</tr>
<tr>
<td>June 1998 to March 2000</td>
<td>48.9%</td>
</tr>
<tr>
<td>Sept. 2008 to March 2009</td>
<td>50.7%</td>
</tr>
</tbody>
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DATA SOURCE: BERKSHIRE HATHAWAY 2017 ANNUAL LETTER TO SHAREHOLDERS.
Career Risk is Real – Value in the Late ‘90s

Buffett: -39%  
SP500: 7%  
QQQ: 110%

Charlie, should we buy tech?

“Warren Buffett may be losing his magic touch.”
It’s All About The Long Haul

- Life changing results in trading come with long-haul application — there’s no shortcuts
- Massive success requires long-term commitment
- Because of compounding, the lion’s share of gains come at the end of your career
- This is why it’s so important to have strategies and techniques that make your emotional state robust
- Without those in place you can’t make it to the long-term
Net worth of Warren Buffett

Warren Buffett's Age
Pain Management

➢ No matter your skill level, you will have to suffer through trying times
➢ Pain happens during drawdowns and these thoughts will surface
  ○ When will this end?
  ○ Do I still have an edge?
  ○ Should I quit?
  ○ Should I change my approach?
➢ You have to have a good handle on your psychology in order to not self-sabotage during the tough times
Stay Positive

➢ This pain is also how you improve and get better!
➢ Remember Dalio’s saying
  ○ Pain + Reflection = Progress
➢ Trading over the long-haul will make you mentally tough, and this resilience will serve you well in other areas of life
How To Succeed And Beat The Pain

➢ Kill Ego
➢ Build Emotional Awareness
➢ Have System Compatibility
➢ I call these prerequisites for success — these are things you need to get right in the beginning in order for your trading journey to be successful
➢ If you don’t have these things in place you risk a downward spiral and burning out of the game when times get real tough
Kill The Ego

➢ If you attach your ego to your trading process it will anchor you to bad trades which sets yourself up for blow up and disaster
➢ Instead of cutting losers you will hold losing positions with the hope of being proven right and looking good among peers
➢ You must separate your self-esteem from your trading ideas in order to succeed over the long-term

If you need help check out this book!
All The Greats Talk About This

➢ Stan Druckenmiller — You need to be decisive, open-minded, flexible and competitive.
➢ Peter Brandt — Strong opinions, weakly held
➢ George Soros — I’m only rich because I know when I’m wrong… I basically have survived by recognizing my mistakes.
➢ Michael Steinhardt — Good trading is a peculiar balance between the conviction to follow your ideas and the flexibility to recognize when you have made a mistake. You need to believe in something, but at the same time, you are going to be wrong a considerable number of times. The balance between confidence and humility is best learned through extensive experience and mistakes.
Tip For Taming Ego

➢ If you struggle with ego issues, do everything possible to avoid publicly publishing your trades on chat rooms, blogs, social media, etc.

➢ Flip-flopping is incorrectly looked down upon in society even though it’s a great thing in trading

➢ Publishing your thoughts makes it harder to backtrack
  ○ We’ve all seen the permabear publishers on Twitter who have been wrong for years....

➢ Ego Test: If you can publish trading convictions publicly and then reverse them when new evidence presents itself you have completed this step
Build Emotional Awareness

➢ You must have the ability to recognize your own emotions so you can intervene when necessary
➢ If you aren’t aware of your feelings then the “monkey mind” will control you and force bad decisions
➢ If you don’t have emotional awareness it’s possible to develop it through writing exercises
How To Build Emotional Awareness

➢ Carefully monitor your emotional reactions to your trading strategy
➢ The next time you feel negative emotions immediately write them down
➢ Capture them in your trading journal, build awareness of them, but make sure to not act off of them
➢ Do the same for positive emotions
➢ Eventually you won’t need the writing as much, you will be able to diffuse emotional thoughts from your monkey mind by simply observing the thoughts and letting them quietly pass
➢ But this takes practice and time — always start with the writing
System Compatibility

- Crucial to get right because you have to execute your trading process day after day for years and years
- If you’re not in harmony with it you won’t last
- You’ll burn out or self-sabotage and kick yourself out of the game
- A deep value guy will never trade like a quant, they think about the world differently, they resolve conflict differently, they have different belief systems that can conflict with one another
- One guy using the other guy’s approach will fail
Incompatibility between trader and system is the single greatest reason most traders don’t succeed, regardless of trading style. They have no emotional connection to their trading rules and methodology. They know trading rules from a technical and intellectual standpoint, but not from a psychological or self-awareness one. ~ Michael Martin
I don't think traders can follow rules very long unless they reflect their own trading style. Eventually, a breaking point is reached and the trader has to quit or change, or find a new set of rules he can follow. This seems to be part of the process of evolution and growth as a trader. ~ Ed Seykota
How To Find System Compatibility

➢ Unfortunately there’s no easy way
➢ You have to try out a bunch of different styles and figure out what fits best for your psychological makeup and lifestyle
➢ Questions to ask yourself
  ○ What works with your schedule?
  ○ What kind of volatility can you take?
  ○ Are you exhausted by open boundaries and discretion or do you love it?
  ○ Are you a qualitative thinker or a quantitative thinker?
The Three Must Haves

➢ Make sure you have these before trading
  ○ A checked ego
  ○ Emotional awareness/mindfulness
  ○ System compatibility

➢ You need to have all of these figured out to maximize your success of a fruitful trading career

➢ But you also need tools and strategies to maintain a healthy psychological state during the day-to-day grind
How To Promote Psychological Peace

➢ Build “de-escalators” into your trading process
  ○ Sizing down when doing poorly
  ○ Scheduled, not impulsive P&L checks

➢ Adopt helpful mental models/philosophy
  ○ Reframing
  ○ Process focus vs outcome focus

➢ Incorporate general health and wellness
  ○ Meditation
  ○ Breaks
  ○ Diet
  ○ Fitness

➢ Have emergency plans in place for runaway emotions
  ○ Logic stop technique
  ○ Time gap
Size Down When Cold

➢ Back down from full size if your hit rate has gone down in the recent past and you haven’t been reading the market well
➢ Especially important for discretionary traders
  ○ Losers hurt confidence which can cause further misjudgement of the market
➢ Stan Druckenmiller is a huge fan of this
One of my most important jobs as a money manager was to understand whether I was hot or cold. Life goes in streaks. And like a hitter in baseball, sometimes a money manager is seeing the ball, and sometimes they're not. And if you're managing money, you must know whether you're cold or hot. And in my opinion, when you're cold, you should be trying for bunts. You shouldn't be swinging for the fences. You've got to get back into a rhythm. ~ Stan Druckenmiller
Impulsive P&L Checks

➢ Staring at your P&L and account balance will trigger your emotions like crazy, look at these metrics as seldom as possible
➢ If you get the urge to check P&Ls outside of a logically scheduled time resist it at all costs
➢ Keep track of your weekly P&L checks by writing them down and then work towards reducing that number to the least amount possible
➢ If you’re really struggling with staying away, delete market quote apps from your phone — this will help curtail P&L checks born out boredom
Reframing

➢ Choose not to be harmed and you won’t feel harmed. Don’t feel harmed and you haven’t been. ~ Marcus Aurelius
➢ Reframing stems from Stoic philosophy
➢ Stoics use an exercise called “Turning The Obstacle Upside Down”
➢ Essentially it’s taking a bad thing in your life and reframing it as a source of good
Reframe Example

➢ You take a huge unplanned loss
➢ Instead of dwelling on your misfortune, you look at that event as a catalyst to overhaul your risk management system so it’s even more robust going forward
Reframe Writing Exercise

➢ Next time you encounter a problem or bad situation write it down
➢ Now write down a way this situation can improve your life going forward
➢ Most obstacles lead to growth so think hard and spend a lot of time trying to find the good out of a negative situation
➢ Go back to this sheet once a month to monitor your progress
➢ Put a checkmark down next to each obstacle you have successfully turned upside down
➢ Work towards a 70% hit rate
Process Focus vs Outcome Focus

➢ Buddhists say focusing too hard on a future outcome just creates a life of suffering
➢ Instead it’s better to focus inward and think about your day-to-day action
➢ With system and execution based thinking you will achieve a feeling of continuous success
➢ Goal based thinking will lead to a feeling of constant failure with only a few bursts of success
➢ In trading if you focus too hard on your month-to-date and year-to-date P&L it will drive yourself crazy
To put it bluntly, goals are for losers. That’s literally true most of the time. For example, if your goal is to lose ten pounds, you will spend every moment until you reach the goal—if you reach it at all—feeling as if you were short of your goal. In other words, goal-oriented people exist in a state of nearly continuous failure that they hope will be temporary. That feeling wears on you. In time, it becomes heavy and uncomfortable. It might even drive you out of the game… If you achieve your goal, you celebrate and feel terrific, but only until you realize you just lost the thing that gave you purpose and direction. Your options are to feel empty and useless, perhaps enjoying the spoils of your success until they bore you, or set new goals and reenter the cycle of permanent presuccess failure. ~ Scott Adams
You want to live your life on the top line
Meditation

➢ Meditation, more than any factor, has been the reason for whatever success I’ve had. ~ Ray Dalio

➢ Meditation builds mindfulness and emotional awareness — these are key tools used to silence the monkey mind during times of stress

➢ Ray Dalio’s favorite Transcendental Meditation teacher, Bob Roth (link here)

➢ Sample routine we use
  ○ Download the Calm App to your smartphone
  ○ Before starting your day do a 10-minute guided session
  ○ Try to hit 14-days in a row to build the habit
Take Breaks

➢ You must plan out breaks away from your trading
➢ Spending time away from the screens and involved in other things is not only healthy, but helpful to idea generation
➢ By spending time on material outside of trading you will be able to approach trading with a new perspective
➢ Neurotically watching charts all day will kill your creativity
➢ Reading sci-fi, fiction, fantasy and literature from other disciplines will open your mind and allow you to find trade ideas that few people can see
➢ Druck’s break in 2000 led to one of his largest trades ever
Now, I will also say that was after a four-month break. **My mind was fresh. My mind was clean.** And I will go to my grave believing if I hadn't taken that sabbatical, I would have never seen that in September, and I would have never made that bet. It's because I had been freed up and I didn't need to be hitting singles because I came back, and it was clear, and I was fresh, and so it was like the beginning of the season. So I wasn't hitting bad yet. I had flushed that all out. But it is really, really important if you're a money manager to know when you're seeing the ball. It's a huge function of success or failure. **Huge.** ~ Stanley Druckenmiller
Diet

➢ ***Not doctors or dieticians — always do what’s best for you***
➢ What works for us is low sugar diets and caloric intake until later in the day
➢ That keeps blood sugar levels stable and prevents crashes and a foggy mind during the most critical parts of the trading day
Fitness

➢ Does wonders for mental health and stress resistance
➢ Ideally have your workouts something that you enjoy
➢ I find that High Intensity Interval Training (HIIT) does the most for me in terms of mental health and psychology
➢ Sample routines
  ○ Exercise bike intervals: 10 minute warm-up, 1 minute hard 1 minute light for 20 minutes
  ○ 4-minute Tabata workout: 20 seconds of burpees followed by 10 seconds of rest — fantastic quick mental fix
Emergency Emotional Control Techniques

Use the following strategies when market volatility gets crazy and you feel like impulsive decision making may take place.
Logic Stop Technique

➢ Once you start feeling the emotion don’t bury it! Write it down!
➢ Now try to observe that feeling from the logical part of your brain
  ○ Ask yourself why are you feeling that way?
  ○ What’s the source of the feeling?
  ○ How intense is the feeling?
➢ Write down all of these observations
Logic Stop Technique

➢ Next write down the potential negative outcomes that will occur if you were to act on the emotion
➢ Hopefully by now the emotional pulls have subsided
➢ By getting them down on paper it’s easier to see how foolish the monkey mind can become
➢ Eventually as you get comfortable with this process you’ll be able to do all of this without the writing
➢ You’ll be able to logic stop on the fly in your own head
➢ This makes you immune to emotional trading
Time Gap

➢ Sometimes the logic stop technique won’t work
➢ The emotion won’t fade and it will compel you to take action
➢ When this happens force yourself to wait on taking the action
➢ If possible, get a full sleep cycle in before acting
➢ Usually after one day’s time you will be able to logically assess rather than emotionally assess if the action makes sense
Summary

➢ Start with the 3 prerequisites for success
  ○ Kill Ego
  ○ Build Emotional Awareness
  ○ Have System Compatibility
➢ Then use the strategies on slide 21 to keep yourself psychologically healthy along the way
➢ Additional Reading Material
  ○ *The Inner Voice of Trading: Eliminate the Noise, and Profit from the Strategies That Are Right for You*
  ○ *Thinking, Fast and Slow*
  ○ *Principles: Life and Work*