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Presents

Trading Psychology  
and Managing your 'Trading State'

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## Chapter: 4

# Chapter 4 : Trading State Management

### *What is Trading State Management?*



State Management is essential to successful trading. **What do I mean by State Management?** Recent trading events can affect your Trading State. Losses can make it harder to execute entries, cause you to break exit rules and stop placement rules.

*Your State refers to the Psychological - Emotional frame and even your Physiological State.* After a losing trade do you find that you are slumped down in your chair? Your breathing is shallow. Your internal dialogue is defeating and negative instead of positive and supporting?



The combination of the **Internal Dialogue** and your **Outward Physiology** **DIRECTLY** affect your decisions regarding the next trade setup and thus your ability to execute your Trading Plan.

Knowing this puts you ahead of the game. When you are aware of something you can address it and make the appropriate and necessary changes to affect positive change. Practicing a couple of simple permanent positive **State Management**

We will use this to prepare ourselves for each setup and we will be using the real world circumstances and **ACTUAL** trading results to validate our point.



“We are the living embodiment of our consistent thoughts.”

## Why is Trading State Management Important?

In the most obvious terms, managing your trading state will dictate your consistency in your trading. Whether it is consistency of execution, pattern recognition, equity growth, or positive mental health, TSM will put you in control over your emotions which have largest impact on consistency.

### Practical Exercise

We'll set the stage so you are aware of the mindset coming into the trading session.



#### Daily Recap of previous sessions:

- ✓ **Monday** - Losing day today of just 6 points but missed an entry by .25 that would have changed the entire outcome of the day.
- ✓ **Tuesday** - Preparing for the FED announcement and it is the middle of August that is typically very difficult to trade due to lower volume and erratic price action. WE miss an entry again by .25 and get stopped on a should-be winner by .25 and are down 24 by end of the session.
- ✓ **Wednesday** - FED announcement and our Trading environment experiences 'Technical difficulties' as the result of lightning. Scrambling all day and FOCUS is shot. -5 on the one trade for the session
- ✓ **Thursday** - Enter long in the morning near the lows and get stopped and then get chopped up in a 12 point range that includes the Philly FED announcement that hits us for a quick 14 points in 3 minutes. Loss for the day; 39 points.



Needless to say, we are on our heels with a pre-market meeting regarding the outlook for the Friday session. LOOKING back reveals that the predictive levels have held just fine and that ½ of the losses could have been avoided with DISCIPLINED trading of our model. But we realize that all trading is subject to Draw downs and that the true measure of a successful trader is HIS/HER ability to handle losses and then come back and execute **BASED ON THE 'RULES OF ENGAGEMENT'**.

The TTFX Trading course trade setups all have “Rules of Engagement” For Entry, Stops, and Targets. As you progress, you will learn these rules that qualify the trades.

We move into the Friday session knowing that we have a HUGE overhang at the 936-940 level from the Sept. 2001 lows that will provide great resistance and the 917.50 number from the previous session is still STRONG support holding the market up. For the session we have had CPI, New Housing Starts out at 7:30 CST and now Michigan Sentiment is out at 8:45 just into the trading session.

Our pre-market analysis shows that the overnight 921 held and we have a \* level there today with our MAJOR support and directional bias sitting at 917.50 DP “R”. So we determine that we are going to be buyers at that level with a relatively tight stop due to the upcoming number being released and that we are going to trade 2 contracts instead of the 3 lot that the model calls for at the Pivot Level. The market has also shown significant resistance at the 925<Daily Pivot> level so a long trade will look to exit there on AT LEAST one of the contracts for profit. We need to ring the register!

Market opens and as anticipated shows no direction for the first 7 minutes and then starts to fade into our level. Of course this is a test of our execution because we are only 4 minutes from the news that could jolt the market and move it quickly in either direction.



AT THIS POINT YOU HAVE TO ‘**MANAGE YOUR STATE**’ AND EXECUTE!!!!

*OUR DECISION YOU ASK?*

**BUY OF COURSE!**

WE SPREAD INTO THE TRADE

**BUY 1 @ 918**

**BUY 1 @ 917**

**SELL 2 @ 914.75 STOP (JUST BELOW OUR 915.50\* LEVEL USING OUR NUMBER ROUNDING STRATEGY**

We are now long 1 at 918 and now 1 @917 and the number is out. Bid / Ask is all over the board and the downside pressure is building as we watch the market tick lower.



Our stomach is in 29 knots and the internal dialogue is something to the effect of:

“What were you thinking trading before a number? We can’t afford another loss and need to ring the register.” Then we start to talk to the market...“C’mon let’s see some buyers here. You do want to go higher don’t you?” DON’T STOP US OUT!!!!” The market trades 915 and the towel guys are wiping sweat out of our eyes so we can still view the impending doom on the screen. And then 916 and 916.50 and we are building and the market trades above the 917.50. OUR STOP HELD! The number rounding strategy paid for itself AGAIN. Subtracting that .25 from the whole number of 915 kept us in the trade and only costs us .25 X \$50 or \$12.50 per contract or \$50 per trade! This has turned so many possible losses into winners and in this trade takes a 5-point loss and turns it into a 10-point winner!



That’s a \$750 turn around, to the POSITIVE, for just \$50. You will see this work time and time again in the real markets. TTFX students call it ‘Number Rounding Stop Placement’. Make it a part of your trading strategy.

### Back to the trade -

We are now trading at the 919 level and the market is rallying although the Michigan number is unchanged from July but still SEEMS negative.

We have an MIT order (Market If Touched) at 923.75 to EXIT ONE contract with a profit JUST BELOW the 925<Daily Pivot> and strong overnight support/resistance at 924.

The market goes to 922.50 and then 923.25 and we are IN THE MONEY and WAIT! Here we go back down. Towels out again and in literally 15 seconds the elation that we felt when we were sure that TRGT 1 was going to be hit and we could



**PULL** the stop up to reduce our exposure and **RING** the REGISTER for a winner turns into ‘here we go again’!

The market is at 919.50 and now 918 and each bar has a 5 point range with erratic movement still caused by the positioning after the number, which, by the way, has only been out for 4 minutes! So, wanting to be SURE that we take some profits on this trade, we exit ONE at market (922 area) and take profits and PULL the stop to just below the low of the last bar.



### DID WE EXECUTE ACCORDING TO THE PLAN?

The market then goes to 925 just 12 minutes later for the first target.

SO Real time we Bot 1 @ 917 and sold it at market (922) +5  
 Plan: Buy 1 @ 917 and sold it 923.75 + 6.75

### Now let's look at the second contract

Bot 1 @ 918 and we sold that at market when the RSI couldn't move higher and the 925 level had held for 6 consecutive bars AND the Michigan number SHOULD be negative and take the market down so

### Contract 2

Buy 1 @ 918 and sold MRKT (923) for + 5  
 Plan: We had an MIT at 930.75 just below R1 +12.75

AND because of the number we only traded 2 contracts instead of 3 that the RULES call for and that 3<sup>rd</sup> contract would have exited on a Trailing Stop at 930.75 for + 12.75

### So, let's review

REAL TIME	Bot 1 @ 917 and sold at 922	+5
	Bot 1 @ 918 and sold at 923	+5
	<b>Total Profit</b>	<b>+10</b>

### Based on the Trading Model

Bot 1 @ 917 and sold at 923.75	+6.75
Bot 1 @ 918 and sold at 930.75	+12.75
<u>Bot 1 @ 917 and sold at 930.75</u>	<u>+13.75</u>

**Total Profit +33.25**





Now, even if we had just traded a 2 lot, because of the NEWS, we still would have made an extra 9.5 points by sticking to the rules. Either way, we booked a much needed profit and re-gained our flow making one more conservative trade for the day to wind up + 14 on the session and 4 more aggressive trades for the day for +20 or more.



The swing of emotions can go from euphoric highs to “I’m never going to trade again” in the course of 1 3-minute bar. *This is just part of the business.*

*The Most Important Element is YOU.*



I submit to you today that your ability to recognize this as fact and then **ACTIVELY** work to **MANAGE** your **TRADING STATE** will be directly correlated to your long-term success in ANY market and for that matter in much of day-to-day life.

### *Questions to Ponder*

Jack Schwager, after writing two books (Market Wizards and New Market Wizards) in which he interviewed some of the world’s top traders, concluded that the most important factor in their success was that they each had a trading system that was right for them. Let’s address a couple of components of the system and see what might be important to finding that model.

- ✓ : What is the weekly goal of the trader?
- ✓ : What is the monthly goal of the trader?
- ✓ : What is the available capital for trading?



You cannot design a system that is right for you unless you know something about yourself. So, start today. Start the process of self-discovery and moving you to a point where it's possible for you to do market research and formulate a comprehensive, integrated Trading Plan.

Think about you and WHY you are trading. Take the time to think about key questions and then can act as a sounding board in the future as you have a log of your thoughts and feelings about trading that you can reflect on. Trading as a career is evolutionary and is in a constant state of change. Just as the markets are dynamic, so is your belief about the markets, the opinions you have about direction and news. This all has to be monitored and kept in check.

### *Plan the Trade and Trade the Plan*

Doing this creates discipline, which helps you develop confidence in a particular trading style.



Without discipline, I submit that MOST trading models are doomed to failure.

With discipline, moderately successful systems can be profitable short and long term and maybe more importantly a trader can look back and determine areas of weakness in the trading style or model that can be improved upon for an increase in profitability.

### What is REALLY important to Trading Success?

Almost every successful trader has realized that success in the markets comes from internal control. This is a radical change for most people. Internal control is not that difficult to achieve, but it is difficult for most people to realize how important it is. Investment success requires internal control more than any other factor. This is the first step toward trading success. People who dedicate themselves to developing that control are the ones who will ultimately succeed.



Let's explore internal control, the key to trading success, from another perspective.

Basically, there are three areas, which are key to successfully trading the market:

- ✓ Psychology
- ✓ Money management / Position Sizing
- ✓ Trading Strategy Development

Most people emphasize system development and de-emphasize the other two topics. More sophisticated people suggest that all three aspects are important, but that psychology is the most important with professionals stating that it is literally 60-90% of the battle. Position sizing follows and includes trade management and finally Trading Strategy is the last.

### *Social Proof*

Ed Seykota, industry recognized trader and lecturer, once taught a college course in trading that lasted ten weeks. He spent the first week of the class teaching basic information about trading. He then spent another week teaching the class Donchian's 10-20 moving average crossover system. However, he needed the remaining eight weeks of the class to convince the students to use the system that he had taught - to get them to work on themselves enough to accept the losses that it (or any other good trading system) would generate.

Dr. Van Tharp, author of "Trade Your Way to Financial Freedom", has argued that trading is 100 percent psychology, and that psychology includes position sizing and system development. The reason is simple: We are human beings, not robots. To perform any behavior we must process information through the brain. Behavior is required both to design and to execute a trading system.

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