Trading in the Zone

This is a brief summary of and excellent book by Mark Douglas
I highly recommend you purchase it and make it part of your trading library

The basic premise of trading in the zone is that we always act in accordance with our beliefs, and if our beliefs are in conflict with operating consistently we will get "hurt" in the market and then the growing fear will prevent us from trading successfully. We tend to focus on what we fear or what we believe and will therefore only see the elements in the charts that correspond to our beliefs.

To trade successfully one must trade consistently, and to do this it is necessary to install beliefs that are completely realistic in the market we are trading.

These core beliefs are as follows:

1. Anything can happen.
2. You don't need to do know what is going to happen next in order to make money.
3. There is a random distribution between wins and losses for any given set of variables that define an edge.
4. An edge is nothing more than an indication of a higher probability of one thing happening over another.
5. Every moment in the market is unique.

1. Anything can happen.

There are always unknown forces operating in every market at every moment.

2. You don't need to do know what is going to happen next in order to make money.

There is a random distribution of wins and losses for any given set of variables that define and edge. What we don't know is the sequence of those wins and losses or how much money the market is going to make available on the winning trades.

On the one hand: The market is only threatening if you are expecting the market to do something for you. If you don't expect the market to make you right, you have not reason to fear being wrong. If you don't expect the market to make you a winner you have no reason to be afraid of losing. If you don't expect the market to keep going in your direction indefinitely there is no reason to leave money on the table. If you don't expect to be able to take advantage of every opportunity just because you perceived it, and it presented itself, you have no reason to be afraid of missing out.

On the other hand, if you believe all you need to know is:
a) The odds are in your favour before you put on a trade.
b) How much it's going to cost you to find out if the trade is going to work
c) You don't need to know what is going to happen next to make money on that trade
d) Anything can happen.

If you know the above to be true, how can the market make you wrong (It can't)

3. There is a random distribution between wins and losses for any given set of variables that define an edge.

If every loss takes you closer to a win you will be looking forward to the next occurrence of your edge, ready and waiting to jump in without the slightest reservation of hesitation.

4. An edge is nothing more than an indication of a higher probability of one thing happening over another.

Creating consistency isn't about trying to gather evidence to determine that the next trade is going to work. **The only evidence you need to gather is whether the variables you use to define an edge are present at any given moment.**

It is not about being right on any particular trade but being consistent in trading your edge, and knowing that the edge only produces a higher probability of one thing happening over another.

5. Every moment in the market is unique.

   Absolutely unique!

Another premise that is necessary to be able to trade without fear is, understanding that an edge is **only an indication of a higher probability of a successful trade** and that it will frequently not work and this does not mean that we have made a mistake.
The example given is a casino running the game of blackjack. The rules of the game of blackjack remain absolutely constant and the casino has a 4.5 percent edge in the game overall, which means that on any given hand the casino may lose but given enough games the casino will always come out ahead.

In trading the forex market we are the casino and our trading rules are the rules of the game. There is a random chance of success on any given trade but if our rules are correct and exactly the same rules are used each time we trade, in other words we consistently plan our trade then trade our plan, then over a number of trades we must make money.

To develop the right mindset to trade without fear or preconceived ideas of what the market will do on any particular trade, we must go through several stages.

The first stage is the mechanical stage.

This stage is designed to:

1. Build the self trust necessary to operate in an unlimited and random environment.
2. Learn to flawlessly execute our trading system.
3. Train your mind to think in probabilities (accept the five fundamental truths above)
4. Create a strong and unshakable belief in your consistency as a trader.

Producing consistent results is the primary objective of this exercise and thus creating the belief in your self that: **I am a consistently successful trader**. This belief in will act as the primary source of energy that will manage your perceptions, interpretations, expectations and actions in ways that satisfy that belief and consequently the objective.

To get to this stage it is necessary to be able to observe your self, that is, you'll have to start paying attention to your various psychological processes. The idea is to learn to become an objective observer of your own thoughts words and deeds. This is your first line of defence against committing a trading error so you catch yourself thinking about doing something that is not a part of the your trading plan. The aim is to do this without judgment or criticism.

This is really a matter of deciding why you want to monitor yourself, so you first need to have a clear purpose in mind. When you are clear about your purpose simply start directing your attention to what you think say or do.
If and when you notice that you are not focused on your objective or on the incremental steps to accomplish your objective choose to redirect your thoughts words or actions in a way that is consistent with what you are trying to accomplish.

Our objective is to create the belief: "**I am a consistently successful trader**".

The second stage is developing the self discipline

Self discipline is defined as a mental technique to redirect our focus of attention to the object of our goal or desire when that goal or desire conflicts with some other component (belief) of our mental environment.

The sole purpose of trading mechanically is to transform your self into a consistently successful trader. If there is anything in your mental environment that is in conflict with the principles of creating the belief **I am a**

consistently successful trader then you will need to employee the technique of self-discipline to integrate these principles as a dominant functioning part of your identity, in other words instil this as a belief.

Once the principals become who you are, you will no longer need self-discipline because the process of being consistent will become effortless. In fact while you still have to try it is an indication that you haven't completely integrated the principles of consistent success as a dominant un-conflicted beliefs.

Pre-defining the risk, only trading when all the indicators are aligned, trading with the trend etc. are all the steps in the process of being consistent.

So once again creating the belief that "**I am a consistent winner**" is the primarily objective.

I am a consistent winner because:

1. I objectively identify my trading edge.
2. I predefined the risk of a every trade.
3. I completely accept the risk or I am willing to let go of the trade.
4. I act on my edge without reservation or hesitation.
5. I pay myself as the market makes money available to me.
6. I continually monitor my susceptibility for making errors.
7. I understand the absolute necessity of these principles of consistent success and therefore I never violate them.

Learning to trade an edge like a casino

The object of the following exercise is to establish the belief in the trading is just a simple game of probabilities.

You are the casino when:

1. You have an edge that genuinely puts the odds for success in your favour.
2. You can think about trading in the appropriate manner (the five fundamental truths);
3. You can do everything you need to do over a series of trades

Then, like the casino, you will own the game and be a consistent winner.

Setting up the exercise

1. **Pick a currency**.
2. **Use the edge** PinPoint.
3. **Trade entry.** If the market is aligned in the way that conforms to the edge variables of the system then you have a trade; if not you don't have a trade.
4. **Stop loss.** The same conditions apply to getting out of a trade that is not working the methodology has to tell you exactly how much you need to risk to find out if the trade is going to work.
5. **Timeframe.** All trading must be in the same timeframe. Though you can use the other timeframes for filters.
6. **Taking profit.** (*I pay myself as the market makes money available to me*)
   If you never know how far the market is going to go in your direction how do you know when and how to take profits? The question of when is a function of your ability to read the market and pick the most likely spots for it to stop. In the absence of an ability to do this objectively the best course

of action from psychological perspective is to diivide your position into thirds and scale out the position as the market moves in your favour.

7. **Trading in sample sizes.** The aim is to expand your definition of success or failure from the limited trade by trade perspective of the typical trader to a sample size of 20 trades or more.
8. **Testing.** Once you have decided on the set of variables that is your edge, you need to test them to see how well they work.
9. **Accepting the risk.** A requirement of this exercise is that you know in advance exactly what you risk on each trade in your 20 trade sample size.

Doing the exercise

The rules are simple: Trade your system exactly as it is designed. This means you have to commit yourself to trading at least the next 20 occurrences of your edge not just the next trade or the next couple of trades but all 20, no matter what. You cannot deviate, use, or be influenced by any other extraneous factors or changes in variables that define your edge until you have completed a full sample size.

This is how casinos make constant money on an event that has a random outcome because they know over a series of events the odds are in their favour they also know that to realise the benefits of the favourable odds they have to participate in every event.
If you believe in the five fundamental truths and you believe that trading is just a probability game, then you will find that this exercise will be quite effortless; effortless because your desire to follow through with your commitment to take every trade in the sample size and your belief in the probabilistic nature of trading will be incomplete harmony. As a result, there will be no fear, resistance, or distracting thoughts.

What could stop you from doing exactly what you need to do when you need to do it, without reservation or hesitation? Nothing!

This exercise is going to create a head-on collision between your desire to think objectively in probabilities, and all forces inside you that are in conflict with this desire.

The amount of difficulty you have in doing this exercise will be in direct proportion to the degree to which these conflicts exist. To one degree or another you will experience the exact opposite of what I described in the previous paragraph. Don't be surprised if you find the first couple attempts at doing this exercise are very difficult.

How should you handle conflicts?
Monitor yourself and use the technique of self-discipline to refocus on your objective, which is to consistently carry out all of the actions that constitute your trading edge. Write down the five fundamental truths and seven principles of consistence and keep them in front of you when you are trading. Repeat them to yourself frequently. Every time you notice that you are thinking saying or doing something that is inconsistent with these truths or principles acknowledge the conflict. Don't try to deny the existence of the conflict; they are simply parts of your psyche that are understandably arguing for their version of the truth.

When this happens refocus on exactly what you're trying to accomplish. Your purpose is to think objectively, disrupt the association process so you can stay in the "now" moment opportunity flow.

Every time you actually do something that confirms one of the five fundamental truths, you will be drawing energy out of the conflicting beliefs and adding energy to the belief in probabilities and your ability to produce consistent results. Eventually your new beliefs will become so powerful that it will take no conscious effort on your part to think and act in a way that is consistent with your objectives.

You will know for sure that thinking in probabilities is a functioning part of your identity when you're able to go through one sample size of at least 20 or more trades without any difficulty, resistance or conflicting thoughts distracting you from doing exactly what your mechanical system calls for.

Then and only then we be ready to move into the more advanced subjective or intuitive stage of trading.