

Forex Asymmetric Risk

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Asymmetric Risk-Taking, Are You Guilty?



Why we cut profits early and let losses run? In this article I would address the real trading psychology behind it. Lets start with a simple test !

Most traders new to Forex are often guilty of letting their losses run and cutting their profits short, even experienced traders do it every once in a while. Before we begin, answer the two questions below. When faced with a scenarios below which option would you prefer?

Scenario 1:

- A. 80% chance of winning \$2,000 and a 20% chance to win nothing
- B. \$1500 Profit for sure

Scenario 2:

- A. 80% chance of losing \$2,000 and a 20% chance to lose nothing
- B. \$1500 Loss for sure

Most traders would chose Option B in Scenario 1 and Option A in Scenario 2. Compare these results with your own answers. If you chose the same then unfortunately you will be among 95% of traders who fails at Forex. Lets look at psychology behind your decisions.

The two scenarios are quite interesting. Our perception of gain and loss changes our behaviour. When the options of a risky scenario involve profits, traders are risk-

averse (risk-avoidance); however when options of a risky scenario involve losses, traders are risk-seeking. The other words, traders tend to seek risk in face of possible loss and avoid risk when profits are at stake.

This asymmetrical way of risk-taking has great implications on trading decisions we make as a trader. Our decision are based “subjectively”, taking in account recent events rather than looking at overall net trading balance. Let me explain:

After a profitable trade, the decision to close trade and take profit on next trade depends on gains made on previous trade. A trader starts to think “ I’ve made enough on the first trade, lets not lose it all and give away all the profits. Take early profit and call it a day”. At the same time, on a losing position trader delay cutting losses and hold on to trades hoping that it will reverse. The result is that trader realize profits way too early while allowing losses to accumulate.

A professional trader just need to act opposite to typical human behaviour. By considering the impact of losses on net trading balance and not on recent history of trading , a trader can make right decision of letting a losing position go early while keeping the profitable position running. Trading Robots have this advantage over manual trading as they help avoid implications of trading psychology.

Another interesting aspect of trading is the impact of losses on our minds. The feeling of losing an amount is much worse than pleasure gained from winning the same amount. Hence traders, hate losing 10,000 more than they love winning 10,000. Psychologically losses have twice the impact, no wonder why a trader don’t want to close a loosing position and willing to risk more.

A good trader is not a trader who makes millions in fraction of a second. A good trader is one who know where to cut his positions. It is not about making money; it is about losing as less as possible when we are wrong. Thus managing the psychological asymmetry in risk-taking is the key for succeeding as a trader. Bottom line "An experienced trader stands out from a new trader not by how he makes money, but how he loses money"

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