When Trading Journals Don't Work

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One of the most common pieces of advice trading mentors give to their students is the keeping of a trading journal. By documenting your trading, the common wisdom holds, you can learn what you're doing right and wrong and speed your learning curve. I happen to be quite a fan of trading journals; indeed, I made journals a mandatory part of the training program at a Chicago-based proprietary trading firm. All too many times, however, I found that the journals did not accomplish their purpose. They became rote exercises that did not get to the heart of either trading problems or solutions. So I thought in this article I'd outline the five most frequent shortcomings with journals and how these can be addressed.

1. **The journal lacks specifics**. Many times the journal becomes an outlet for the trader, a way of venting. While there is nothing wrong with venting per se, it is hard to see how *simply* venting in a journal can improve performance. A common entry might state, "I overtraded a slow market and broke all my rules. I know I have to take what the market gives me. Tomorrow I need to trade with more discipline". All these things may be true, but the entry lacks specifics regarding *why* the trader overtraded; *how* the overtrading will be avoided in tomorrow's trade; and *what steps* will be taken to return to the discipline. A journal entry that lacks specifics is a statement of good intentions; not a plan. If your journal entry does not include concrete steps that you can follow to address a problem situation, it is unlikely that it will serve as an action guide.

2. **The journal emphasizes problems, not solutions.** Traders love to keep journals when they're losing and then fall off the journaling bandwagon when they're making money. I would argue that, when you're making money, that's the *best* time to keep a journal. Your goal should be to replicate successful trading patterns, not simply analyze problematic ones. The ideal journals isolate what traders do when they're trading their best, so that these solution patterns can be isolated and mentally rehearsed as part of a learning process. At their worst, journals are like bad parents who chastise their children when they're doing something wrong, but never offer attention and praise for good behavior. Kids learn to resent such parents, and traders learn to resent problem-focused journaling.

3. **The journal talks too much about the trader and not enough about the markets.** Journals are a learning tool, and your ultimate goal is to learn how to trade. By focusing exclusively on your state of mind, what you did or didn't do in the trade, etc., you lose the opportunity to identify and learn patterns that appear in the market. It's extremely helpful to

review a market day and examine what you could have noticed to alert you to a market move. Perhaps oil made a breakout move preceding a break in the equity indices; perhaps a move in the currency markets could have given you an early read on how the market would respond to Fed news. By retrospectively identifying such trading patterns, you train your mind to look for them the next time they appear.

4. **The journal is reactive, not proactive.** This is part of the venting phenomenon: traders will make journal entries after the market day, but rarely use the journal to actively prepare for the coming day's trade. An ideal journal captures what you'll be looking for in the coming day in the markets (anticipated setups) and what you'll be working on in your own trading. Think of your trading as a business and your journal as your business plan for the day. A business plan should reflect your strengths and weaknesses and identify areas of opportunity. A business plan should also detail how you will exploit that opportunity. Learning from past performance is important, but if the learning is not reflected in future plans, it will not be reflected in actual trading outcomes.

5. **The journal lacks metrics.** This is perhaps the topic I am most passionate about. I have found that traders can best assess their strengths and weaknesses by keeping detailed records of their trades and by evaluating themselves across a series of performance measures. I cannot tell you how many traders I've encountered who don't have the faintest notion of their average profit per trade; their average win size and loss size; their average holding period per trade; etc. It's not that the traders don't care about performance; it's that they have not drilled down to the trade-by-trade level to see what they're actually doing in the markets. Many times, traders *think* they're trading one way, only to find out when they look at the data that they're not trading that way at all. It's hard to see how a trader can identify if they're having problems trading in the morning vs. afternoon; if they're more often right on the long side than short; or if they are trading large size differently than smaller size if the statistics are not there to be analyzed.

So what's a trader to do? The first step is to decide whether or not you really *want* to know what you're doing and how well you're doing it; whether you want to put in the time and effort to identify the patterns in each trading day—the market's and your own. To paraphrase U.S. college basketball coach Bobby Knight, many traders want to trade and many want to win, but not many are willing to put in the work it takes to be a winner. While Coach Knight has earned his share of criticism, look at the pure effort he puts into preparation for a coming game. The same intensity of effort can be found in Tour de France leaders Lance Armstrong, Ivan Basso, and Jan Ullrich, as they actively train, plan, and rehearse for each stage of the race. This is the effort required of a winner, and each trader needs to know if he or she has the fire in their belly to sustain such work.

Ultimately, the effort to win is sustained by a desire to know. Excellent traders are always keeping score: they want to know what they've done right or wrong, and what's making and losing them money. They are always working on themselves and their trading. I've met far too many "breakeven" traders who, upon inspection, have been losing money consistently. It's not that they're lying; they simply don't want to know the truth. Thus, they avoid it. It is simply too painful to look at the money and opportunities lost. Keeping a journal *should* be painful at times, but it should also bring out the best in you. Without it, you're likely to be a business without a plan.

Trading Journals That Work

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In my last article, I covered some of the pitfalls of trading journals. In this piece I'd like to cover some of the features of trading journals that I have found helpful in my work with new and experienced professional traders. My goal as a trading psychologist is to do all that I can to accelerate traders' learning curves. Sometimes this means helping traders with emotional problems, but just as often such problems are the result of trading difficulties and not their cause. A journal, properly constructed, is a powerful tool for learning—and relearning—markets and cultivating exemplary trading behaviors. Here are some of the principals that have guided my journal-based work with traders:

1. Make journals a part of the daily routine – Even if you don't trade on a particular day, it is valuable to review the day's setups and behavior at key price levels. Reviewing patterns on different time frames can also help traders internalize the context of the markets they are trading, as well as the interrelationships among those markets. The French scientist Louis Pasteur observed that, in matters of observation, "chance only favors prepared minds". Replaying market days, reviewing your own performance, and identifying missed opportunities prepares you for future performance, as your increasing familiarity with trading patterns sensitizes you to them in real time.

2. Incorporate specifics in your journals – If I had to identify the single most common shortcoming among trading journals, it would be their absence of detail. Entries such as, "I lost my discipline; I have to be more patient," might be nice as post-it reminders, but are inadequate as journal entries. Journals need to clearly state what happened, your assessment of why it happened, and the specific steps you intend to take to deal with the situation in the future. A good rule is that anyone reading your journal

should be able to identify and follow the exact same steps that you intend to take in the future. Your journal should be a planning document, not a statement of intentions.

3. Wherever possible, review your journal entries with a valued colleague or mentor – When I established a training program for new traders, one of my first steps was to insist upon daily review of trading journals. This required me to create a trusting and constructive environment, so that traders would be honest in their entries. Once that openness developed, the daily reviews became proactive planning sessions (usually shortly before the start of the trading day) that addressed issues before they could damage the profit/loss statement. Even more important, the daily review created expectations of accountability, as traders knew that my inevitable question would be, "How did you do with your goals for the day?"

4. Use journals to review positive trading performance, as well as problems – The number two shortcoming among journals is their focus on problems to the exclusion of solutions. If journals become a mere recounting of one's flaws and inadequacies, traders will inevitably lose interest in them. Traders can learn as much from what they do right as from their errors. My favorite instruction to new traders is to highlight in their journals one thing that they did right the previous day that they want to replicate today and one thing that they could improve upon in today's trading. This forces traders to stay in touch with their strengths, as well as their failings.

5. Each journal entry should include material about the markets and material about the trader – It is not unusual for traders to emphasize one at the expense of the other. The core concept I stress with traders is that of pattern recognition. Traders display patterns in their behaviors: some of these are positive; others interfere with profitability. Markets enact their patterns as well; it is the trader who can see these as they emerge and act quickly that has the best chance of long-term success. Including material about trading patterns and traders' patterns makes the journal a learning tool about oneself and the markets.

The best trading journals I have observed have been ones that are creative and rigorous. Here are the two most important steps I believe you could take to turbocharge your journal:

1. Make it a multimedia project – Writing a journal in diary form is good, incorporating annotated charts is better, but including video is best of all. Programs such as e-Signal allow you to take screen captures of the market at any time of the trading day and also allow you to replay market days and review their unfolding. Better yet are desktop video programs such as Camtasia (www.techsmith.com) that create highly compressed video files of your desktop activity. This allows you to capture the day's

trade in its entirety, which you can then annotate by adding a voice track. Ninety percent of pattern recognition is repetition: seeing enough variants that you become sensitive to essential and inessential features. While static charts are better than nothing, they do not capture the unfolding of patterns: the very thing that traders need to be able to recognize and act upon. Videos provide the opportunity to see patterns over and over again, accelerating the recognition process. Multimedia journals also actively engage the trader and allow traders to process markets via multiple modalities (images, sound, text, etc.). Educational research tells us that learning is most likely to occur when learners are actively involved in the acquisition of knowledge and skills. An engaging, multimodal journal is apt to be a better learning vehicle than a dry diary.

2. Incorporate metrics – I could write a book on this topic. It is absolutely amazing how much more traders can get from their journals if they include basic statistics about their performance. Trading tendencies that escape normal notice suddenly stand out when summarized statistically. Areas for work and areas of improvement also stand out. With statistics, we can not only say that a trader made improvement, but can actually measure that improvement and track it over time. Such statistics capture improvements that will eventually show up in the profit/loss statement, but which may not be immediately evident.

Here are my favorite trading metrics for active traders:

- Number of winning, losing, and scratched trades;
- The average size of winning and losing trades;
- The average holding time per trade, and the average holding time broken down by winning, losing, and scratched trades;
- The number of winning, losing, and scratched trades broken down by long and short positions;
- The number of winning, losing, and scratched trades broken down by time of day;
- The average holding time per trade for long and short positions and broken down by time of day;
- The number of winning, losing, and scratched trades for days categorized as uptrending, downtrending, and neutral;
- Daily profit/loss, also broken down for days categorized as uptrending, downtrending, and neutral;
- The sequences of winning and losing trades during a day and from day to day;
- The largest winning and losing trades during a day and during a week;
- The largest winning and losing days during a week and during a month.

Less frequent traders can keep these statistics manually. Very active traders will benefit from programs that automatically capture trade data and summarize performance, such as Trader DNA (www.traderdna.com). The data provide very helpful benchmarks that allow traders to diagnose problems and track improvement.

Here are a few of the areas for improvement that commonly emerge from statistical analyses of performance:

- Holding onto losing trades as long or longer than winners;
- Trading with a persistent long or short bias that is not supported by market trends;
- Significantly different profitability during morning vs. afternoon trading hours;
- The tendency to have strings of winning and losing trades;
- Significantly different profitability during different market conditions, such as trending markets or volatile ones;
- The tendency to give back the results of many profitable trades in a few large losing ones.

When you combine rigorous metrics with a multimedia journal, the result is the kind of ongoing quality improvement process that typifies the finest business organizations. The best trading journals are technologies for learning and self-improvement. This takes time, effort, and creativity, but the results are worth the investment.