TRADING PSYCHOLOGY
"RECENCY BIAS"

The term "RECENCY BIAS" may not appear to be very familiar with you as a trader, but as traders I can pretty much guarantee that we have all experienced it.

Recency Bias is the tendency for traders to place more importance on recent trades and to place less importance on less recent trades. Recency Bias can have a very negative effect on a trader's results. Lets say that two traders have the exact same profitability over the course of 2014 to date. However, Trader A for his last three trades was 100% profitable and that Trader B has lost money with his last three trades. Even though for 2014 they are equally to the penny as profitable as each other, who do you think feels more positive? Trader A, of course. In fact, Trader A probably feels like he can run a mile in 3 minutes and never lose money again at Forex trading after having three consecutive profitable trades. Of course, Trader A has lost plenty of trades, but chances are the past three profitable trades will make him euphoric.

Euphoria will likely lead to bad decisions by Trader A. Trader A will ignore possible warning signs and enter a trade that typically does not fit his TRADING PLAN criteria. This increases the odds of a loss. Shaking his head, Trader A cannot believe he ignored those signs and gave back some of his profits from his profitable streak. Even if he is able top right the ship and go back to a neutral mindset, he has still lost a trade due to mental error. Of course, every trader will lose trades, but emotional errors (such as ones caused by euphoria) are the reason that most traders that would otherwise be successful don't live up to their potential. If Trader A does not become emotionally neutral after his euphoria driven loss, the loss to his broker account can be even greater.

Trader B probably feels as if he will never have a profitable trade again after three loss making trades. Sure, he has had plenty of profitable trades in the year so far, however, the last three losing trades will have him thinking very negatively. Trader B will be more likely to make one of two mistakes at this time. First, he could abandon his TRADING PLAN rules and jump into a trade that does not meet his trading criteria because for the last three trades the criteria just hasn't worked. This sounds a little irrational because the same criteria has led to long term profitability, but I would guess that most experienced traders have done exactly what I have just described at some point. Second, Trader B could pass up on a perfect trade set up that fits his TRADING PLAN guidelines because he is fearful of losing again. Both scenarios can be disastrous to a trader's mindset.

Clearly, it is important to avoid these mental mistakes and minimize the effects of recency bias. So how do we avoid succumbing to the negative mental influences that can be caused by recency bias? The first step is to keep a track record that includes every trade, how much $$$ was made or lost and a total equity running total. That way you can accurately track progress over a long period of time. This makes it much easier to think about on a longer-term basis. If trades are not tracked, the past few trades will have a far greater impact on your mindset.

The second step is to write out a trade checklist with your criteria lifted from your TRADING PLAN. That way, you are more likely not to enter every trade unless it fulfills all of the criteria. You will also be more likely to enter every trade that does fulfill your TRADING PLAN criteria. This may seem meaningless, but it is much more difficult to ignore your trading rules if you have to physically put a check mark next to each of your criteria before taking or passing on a trade.

The third step to minimizing recency bias is to know yourself. Some people are more emotional than others If you are prone to making emotional decisions, take a day off from trading if you have had either three profitable or three loss making trades consecutively. Trading under emotional distress is not profitable. If you can handle emotions well, perhaps waiting that day is not necessary. Usually a full nights sleep will help negate recency bias, especially if you have a detailed track record to go over the next morning that reminds you long term results are more important than the past couple of trades.

Remember, it is very challenging for the human brain to completely overcome recency bias. However, its effects can be devastating to a trader's mindset as well as their equity. Therefore, it is important to take the above steps to minimize the negative effects created by recency bias.

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