

Is Day Trading Like Gambling?



This answer to this question is based on the strategy and investing style of the participant. I can tell you without a doubt that trading in the markets is not like gambling at all.

Gambling has a fixed odds system for all major games, while trading in the markets is truly unpredictable. The "house" or market does not have any unfair advantage as with casino style games.

If you are able to exercise extreme discipline and laser focus on your trading strategy, you can profit in the market. However, if you approach the market with random abandonment, then the market can and will cause you serious pain.

In this article I will cover 8 areas that can help you recognize if you are displaying characteristics of a gambler and not an investor.

Question #1 – Are you going all-in?

Depending on your account type and the market you are trading, brokerage firms will extend you what's known as margin to trade above the cash equity you have in your account. If you are day trading in the US, that value is 4-to-1 to cash on hand.

Now, if you are day trading, you should be determining your risk-to-reward ratio for every trade and applying sound money management principles for each transaction.

If you find yourself going all-in on positions, this is a sign that you are taking unnecessary risks for the hopes of a windfall profit. Examples of this would be if you have 100k cash with 400k margin and you are using all 400k for one day trade.

Earlier in my career I couldn't handle the fact it was going to take me years to build up my trading account, so I would take these ridiculous positions going all-in on margin with penny stocks. Before I would take my position, I would have a sound trading plan, but in reality this plan was a cover up for my own need to hit it big.

If I am owning it now over a decade later, I was just swinging for the fences because I wanted to break free of corporate America in order to trade for a living. It got so bad at one point that I started to take on large options positions in the hopes of making 5x or 10x my money. Such a scary thought now that I'm looking back on my trading behavior.

Do you find yourself occasionally or worst frequently going all-in on a sure bet? If so, this is a clear sign that you are crossing the line from a savvy investor and characteristics of a gambler.

Question #2 – Do you find yourself overtrading?

Gamblers will often try to bet themselves out of a hole, which most times leads them further into financial ruin. You can display similar behavior with the market if you go on a bad run.

No matter how good you are as a trader, you will encounter dry spells. It will feel like the market is against you and you are unable to pick a winner. Smart traders will either stop trading for a period of time or will start to take smaller positions until they are able to sort through their slump.

If you find yourself trading more heavily during a downturn or worst using more money to dig yourself out of a whole, you have now crossed the fine line between gambling and investing.

I remember a time where I was day trading and the market had given me a few lumps by 11am. Instead of trading smaller or stopping altogether for the day, I decided to “beat” the market. I began taking on position after position, so much so that by the end of the day I felt like I had been through a meat grinder.

I think I may have been up or down a few hundred bucks after all that work. I remember saying to myself, “What are you doing?”

I may have had a few days of overtrading on that level afterwards, but if you are becoming somewhat of a gambler, you will notice that the majority of the time you are overtrading.

This need to overtrade is the same thing a gambler feels when they need to place more bets to “fix” the problem.

Question #3 – Are you using credit to trade above and beyond margin?



Under no circumstances should you be using credit cards or taking out loans to place money in the market. Think about it, the market already provides you margin which allows you to trade above the available cash on hand. Why would you need to then take out more money?

The simple answer is greed and a little bit of stupidity to boot.

Please answer the following questions:

1. Are you using credit cards to fund your trading account?
2. Have you used money from a home equity line?
3. Are you borrowing money from loved ones?

If you have answered yes to any of the above questions, stop whatever you are doing and replace these funds, because you don't actually have the money!

It is one thing to lose your own money, but you should never allow the market to place you in a position where you are going in debt due to your trading. If you can't turn a profit with your own cash, what makes you think you will turn a

profit with borrowed money? It's not about trading larger in order to make money; it's about trading smarter with what you have on hand.

Question #4 – Do you have erratic mood swings?

A major sign that someone is a gambler is when their mood swings start to fly all over the place. The person can be high as a kite one day and then completely depressed the next. This sort of behavior comes from the highs of placing winning bets, only to be replaced by depression from big losers.

Trading if not treated as a business can have the same effects on your relationships. You will find yourself avoiding your loved ones, because you don't want to face the music if they ask you how your trading is going.

You will start to find time with your family as a distraction from your very important task of performing more and more market analysis.

Your family will not know which guy they will encounter after each trading day. Some days you are completely normal, while on other days they would rather have dinner with a sociopath versus dealing with you.

Trading should have no impact on your emotions. This is always the first sign of a good trader, the ability to stay completely flat in an environment that is filled with raw human emotions such as fear and greed.

Have you begun to notice your family maybe walking on egg shells around you after 4pm?

Question #5 – Do you have trading rules?

Trading effectively boils down to a number of fixed rules that govern how you conduct your business. This concept of rules applies to the market, because the market is a living and breathing entity, where no one can predict her next move.

This level of chaos can drive a man insane if he does not equip himself with clear boundaries of how to engage with the market.

Over time, if you are finding yourself abandoning rules in order to place random bets in the market, you are in trouble. This is a clear sign that you are no longer concerned with establishing a rationale for your trades and have instead opted for the ability to just place trades whenever and wherever you want.

This sort of behavior is similar to the gambler who is not concerned with calculating odds, but would rather just stay in the game and place bets.

How do you think this hope for the best mentality will play out in the markets?

Question #6 – Is the market your entire universe?



Let me qualify this a bit, because I would say I am one of the most passionate people when it comes to trading, so I get it if you dream about charts at night.

When I ask the question, is the market your entire universe, it's more about has the market replaced all of your relationships?

Do you find yourself only talking about the market with everyone you encounter? You go to subway to order a meatball sub and you somehow make the correlation with the bread to the current trend of the S&P 500.

If you find yourself no longer having any desire to enjoy the smaller things in life, you could be heading down the path of losing yourself by focusing on the market so much.

This is very similar to the behavior of a gambler who completely shuts out the entire world to focus on their game

of choice. Simple tasks like putting your kids to bed or even eating will be too laborious.

Question #7 – Do you deny that you have a problem?

If you are trading poorly, odds are there is at least one person that will know this fact. If you are married it's likely your spouse. Either because you share this bit of information because of your loving relationship and great communication between each other, or they will know because of the shrinking joint account balance.

At some point your spouse or close friend will confront you about your losses. This confrontation will likely be awkward as they will not have a firm understanding of how the market works, but on a common sense level will know that whatever you are doing is not working.

When confronted a trader that is gambling will deny everything no matter what. The gambler will likely take it a step further and begin attributing their market losses to some inefficiency in the market. Never will it be about his or her trading, it will always be someone else's fault as to why they can't turn a profit.

If really pressed, the gambler will likely act out in such a fashion that the close friend will probably avoid discussing trading or money with them ever again to avoid future conflicts.

Does this sound like something that has happened to you before? Do you find that the market or some insiders are always out to get you which is why you can't win?

Think about the gambler that sits in front of the television yelling at the fact the weather isn't right, or the coach keeps making bonehead calls. Are you any different from this

fellow?

Question #8 – Are you using stops?

Before you enter each trade, have you determined where you will exit a position if you are wrong? Not to be a stickler, when I say a stop, it doesn't mean you have to enter a live order. You should at a minimum have a mental stop where you will exit a position if it goes against you too far.

Having a stop is critical in every trader's career; because it is your way of saying I am wrong in this particular situation. You are no longer fighting the market or making the newbie mistake of letting your losers run way against you.

The other method for using stops is when you are up on a trade and you want to make sure you don't walk away a loser. Stops will often be the one thing that separates a winning trade turning into a loser due to some unforeseen even in the market.

Stops are the same method that good gamblers use when betting in casinos. They come into the casino with a set amount of money they are willing to lose. Then once up for the day or on a particular game, they have a set amount of money that if they begin to give back money to the casino they walk away.

This ability to walk away a winner is the actions of an investor. If you find yourself giving back healthy gains for losses because you are not willing to put in stops, you are just gambling. Hoping for some larger target or profit zone.

To trade without stops opens you up to tremendous risk for potential loss.

So, let me ask, do you use stops?

In Conclusion

Most people that trade do so sloppily. Where the line begins to cross between sloppy investing and outright gambling is the frequency of the violations of the questions mentioned throughout this article.

You have to be honest with yourself. If you are day trading and violate any of the questions listed above, you will fail at trading. I know that sounds harsh, but it is the grim reality of the market. She has a crazy way of separating people from their money when they act erratically.

To see how we can help you regain your trading discipline, please head over to our homepage and checkout our trading simulator.

All the Best,

Al

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