



Conviction

Why is Conviction important in trading?

It can make a world of difference. Let's start with an example, let's say we see an aggressive option buyer in ABC stock in XYZ sector. If you decide this trade is appealing to you – how much size are you going to take, what is your holding period, what is your stop price, are you going to stick with this trade through thick and thin? These are things to think about before trade entry that will give you a **level of Conviction in your trade**. Other factors to think about are, “do you really like this company and do you like this sector?”

Your level of Conviction may help you determine all the questions above and may help in whether the trade ends up being a winner or loser.

Why? Let's go back to our example above

ABC stock in XYZ sector saw aggressive call buying

Let's say you did not determine your level of Conviction going into the trade entry. What will happen if ABC doesn't move in the first days of the trade or even worse, if the stocks dips. What are you likely to do or at the very least what could happen? Odds are you may give up on the trade and sell because you did not determine your level of Conviction and realized that it was pretty low after the fact. So, let's try to solve this issue by first examining the difference in Conviction levels that I use:

High Conviction:

- It is a stock and sector that I want to be in (I have conducted my own research)
- The stock is setting up technically (for simplistic reasons, let's say there is support near)
- Option call buying / institutional support

Low Conviction:

- Less favorable sector (meaning a sector that you are borderline on, do not have strong feelings)
- Technicals are neutral
- Option call buying / institutional support

For me, absent a name breaking down technically, this will determine how long I may stay in a trade. **Trade size is important. Do you want to take the same trade size in a Low vs High Conviction setup?** This is where in my opinion, sizing a Low Conviction vs High Conviction trade & determining this on trade entry can help with profitability. Now, your trading process still has to be disciplined and follow a process but if **your size is too large in a Low Conviction name you may get shaken out of a profitable trade or worse sell on the low because you realize you don't have any Conviction to stay in a trade where you have too much skin in the game**. However, if you size a **Low Conviction trade appropriately, there will be less of a probability in my opinion of selling at wrog time**.

So, why not only take High Conviction trades? One can make a case for this, but there may be many reasons that you may want to take a Low Conviction trade. It may be for diversification, it may be a event driven trade, or it may be trade that you saw huge call activity / institutional that you want to participate in. **The bottom line for me is to determine the Conviction Level prior to trade entry may give you the patience & confidence to stay with a trade and not sell at an opportune times**.

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