Use Crypto Market Psychology to Make a Profit

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In economics, markets are an abstract concept: they are comprised of systems, institutions, price action, contracts, digital and physical infrastructure, and much more. When thinking in these terms, it is sometimes easy to forget the individual people behind the abstraction.

Be it stocks or cryptocurrencies, it is the everyday decisions of people — traders — that ultimately drive the markets as a whole. Those individual decisions are affected by a huge number of factors, such as rationality, access to information, risk aversion, and more — all of which the traders possess in differing degrees.

Numerous personal considerations, both logical and emotional, go into each economically significant action of a market participant: the fundamentals of an asset (importantly, estimated to the best of a trader's abilities), recent news, social media gossip, fear of missing out (FOMO), diamond hands and so on. All the individuals' decisions to buy or sell, informed by these considerations and multiplied by the resources at their disposal, ultimately combine to force the price of an asset up or down.

Regardless of the sometimes vast differences of opinion between the market participants, there always exists a sort of aggregate, combined attitude that defines the market sentiment at any given moment. The concept of market psychology refers to this phenomenon of prevailing sentiment. Taking that psychology into account when trading or investing can lead to better-informed decisions, thereby increasing the chance to make a profit.

How to Use Market Psychology to Your Advantage

The basic, very simplified idea here is to bet against the prevailing market sentiment. When the majority of traders are optimistic and are falling over each other to purchase an asset in hopes to see it grow, a prudent move is to take advantage of the resultant high prices and lock in your profits by selling — ideally at the very peak of the buying craze.

Conversely, when disappointment or fear sets in and the prices start falling, the way to make a profit is to buy in at the highest point of market despair and, consequently, the lowest price — with the assumption that you'll get your money back, plus extra, when the prices rebound.

A word of caution though: this last rule is not an immutable one specifically for the crypto markets due to the fact that sometimes a large drop in price coincides with the ultimate death of an asset either via a rug pull or the simple disappearance of interest towards it from the investors. While a "dead" coin can very rarely surge years after its demise due to some black swan event, it is much more common for a project that had at one point lost 99%+ of its value to remain in such a state indefinitely.

Now, all this sounds very good and simple on paper, but in reality, gauging and especially predicting the prevailing market sentiment is an immensely difficult task.

Market psychology has a kind of fractal, timeframe-dependent nature: what you estimate to be a period of energetic buying activity could be a brief moment of misguided optimism within a dominant months-long downtrend, which itself could be a temporary cooling of tempers within a years-long bull market.

This imposes multiple layers of complexity on every trading decision that can never be peeled off with 100% certainty until after the price action has already played out — one can never be absolutely confident that they've picked the timeframe and timed their move correctly. The best a trader can hope for are informed guesses with varying degrees of ultimate correctness.

In order to simplify the task of this guesstimating, it can be useful to categorize the different states of prevailing market sentiment — such delineation makes it easier to identify the current market attitude by the virtue of providing a familiar pattern.

The most widely accepted categorization of traders' sentiments is one of bull vs bear markets: let's have a more detailed look into them.

What Is a Bull Market?

A bull market (called so because bulls tend to attack their foes with an upward thrust of the horns) is one of prevailing optimism and confidence. It occurs when a sufficient number of market participants believe in the underlying premise of an asset. Whether it is due to the project offering some comparative advantages over competition or pure hype, people are onboarding.

Regardless of the specific reason, the asset is bought in much larger volumes than it is sold, driving the price upwards and, in turn, attracting more attention from new investors. If there are periods of selling, they are brief and intermittent, and not enough to undermine the overall confidence in the market.

What Is a Bear Market?

Bear markets (another animal analogy — bears attack with a downward swipe of their claws) are the opposite of that. The dominant moods are those of disappointment, fear, and despair. Lack of confidence in the development team, the emergence of more successful competitors, a decrease in marketing/hype, or suspicions of a crypto scam can all cause people to give up on an asset.

The cryptocurrency gets sold more than it gets bought and the price trends downwards, even though the fall can be at times interrupted by upward rebounds.

Bull vs Bear Market

As we've mentioned earlier, identifying bull vs bear markets is as much (if not more so) a matter of choosing the correct timeframe, as it is of carefully attuning to the traders' moods. In an age of social media and constant online communication it is not particularly hard to at least estimate, if not pinpoint, what is the aggregate public opinion in regards to a particular asset. What's hard is determining whether the current mood is a fleeting one or indicative of a long-term trend.

One tool that many uses to help resolve this problem is technical analysis — the practice of studying the patterns of price movement on the price charts and using known regularities to predict future movements.

Technical analysis supposedly allows to cut through the complexity of human reasoning and emotion and get straight to actionable information. While TA is, to a degree, a controversial tool — with some saying it's not that far off from astrology — it can sometimes become a self-fulfilling prophecy; if enough traders believe in the patterns, they will act accordingly, leading to predictable results.

Ultimately, while day trading an asset based on market psychology can be very lucrative based on one's deep understanding of the prevailing mood, strong analytical skillset, or sheer luck, it by its very nature relies on taking a high risk — and the higher the potential profits, the higher the risk.

If you are looking to try yourself out in this space, we strongly recommend starting out small and only trading with amounts of money that you are comfortable with losing.