MarketFocusing

The Science of Gut Feel

by Flavia Cymbalista, Ph.D.

In a March issue of Fortune Magazine there was an article, "The Bond King", about how PIMCO's Bill Gross beats the market. The article asserts that Gross preys on the element of certainty through his mathematical models, but masters the element of uncertainty with his gut. So how does he do it? The article seems to give some credit to his Yoga teacher - but it cannot explain it.

George Soros talks about his gut as well. He says that he combines analysis with instincts. But while he can say a great deal about his analytical framework, he can't say much about the knowing of his gut. All he can say is that his instincts pick up profit opportunities. And that his back hurts when there's something wrong with his portfolio - apparently his body knows it before his intellect does. But how does that work?

Most traders know the advantage of an accurate gut. You probably recognize this kind of knowledge. There are times when you are completely seeing the whole game, the players, the entire scene. Times when you have a strong sense of where you are. You smell the market and the momentary situation seems transparent, your gut knows how it is going to develop. Even more common, traders often find themselves thinking that a certain course of action makes sense while simultaneously feeling uneasy about it. The best traders learn to value such gut reactions. But the gut knowledge itself is opaque and mysterious. Even the traders that make best use of it don't know how they do it. They can't tell you where it comes from or how they got it. They can't tell you if it's possible to learn it better. They can't teach it to anyone else.

With *MarketFocusing* gut knowledge can be understood, learned and improved. *MarketFocusing* teaches you how to think with your gut. It's not an alternative to analytical approaches but rather complements them.

Why Is Gut Knowledge Mysterious?

Gut knowledge has been mysterious for reasons having to do with a fundamental idea of Western culture. Our way of looking at the world has been reductionist. We look at the world by considering its parts. We analyze problems by breaking them down into smaller pieces. We isolate determining factors, and when their influence doesn't remain the same over time, what will happen seems random and indeterminate. That's because we have no way of thinking about the transitions from one whole scene to the next. Reductionism is the essence of Western thought - a powerful method that goes a long way toward explaining the success of the West in science and technology. But gut knowledge is the knowledge of whole things and how they unfold.

Reductionism is also at the core of most approaches to investment. Most existing investment theories are attempts to structure, to find a specific type of order within market reality. They try to make sense of the market process by delineating factors that are determinant of prices and identifying indicators that can be used to predict the future course of prices. Different models emphasize different factors; they differ in how they define the determinants of market events. But they share the assumption that market events are determined by factors that can be isolated, and by viewing that which is not covered by such isolated factors as indeterminate and unpredictable. Each of these models presents a different cut of market reality. But gut feeling captures that which eludes any particular cut of market reality: intrinsic uncertainty.

We know that there is a multiplicity of ways to beat the market. But we also know that no single model will always succeed. There are situations where we have good grounds to believe that the future will be like the past, that's where models work best. But when the rules of the game are changing, we can't rely on fixed procedures and static rule-based systems to tell us what the best course of action is. Our biological software becomes indispensable for mastering uncertainty.

Intrinsic Uncertainty

Intrinsic uncertainty is something that everyone knows from experience. There are an infinite number of variables driven by the human condition that are impossible to capture in a neat formula. But the difficulty is not just a computational one. The problem is not just that there are too many factors and too many configurations, too many ways in which those factors can be arranged. Nor is it the question of finding the exact right cut of reality. Intrinsic uncertainty means that the market process is such that logical reasoning first requires a “cutting” and also that we cannot assume that a cut will last through time.

Uncertainty stems from the fact that the market process does not consist just of factors that we can define. Any event always has many more aspects than what could be listed sequentially. We usually think of things one by one, we isolate factors and relationships. But in the living world factors don't act like they do in math, where 2 always stays 2, whether it's just 2 or a factor in 34. Market reality does not come already “cut” in the unit-factors that the models take into account: it is an intricate whole that can be “cut” in many different ways. Re-dividing up the processes in different ways allows the relevance, or irrelevance, of certain factors to appear in a different light. This is why so many different, apparently contradictory strategies can succeed.

The future is uncertain because it's continuously in formation. It's always in the process of being formed. In the process, any aspect you can isolate will affect and be affected by all others. Each one changes what the others really are. What we call “a factor” could only have an independent effect if it stayed separate from all the events, from the whole scene. A factor never acts solely as we think of it but only as it is instantly changed by being in with all the others. This means that we cannot fully grasp the import for the future of any of the aspects of market reality without a situational sense. It's only with our felt experience that we can know a scene as the intricate whole that it is.

Gut Feeling v. Emotions

Eliminating emotionality in trading is the number one reason why many market participants choose to rely exclusively on mechanical trading. They are not making use of the edge that can only be found in their experience. They have to set their more organic bodily reactions aside because they cannot differentiate between gut knowledge and emotions.

Gut knowledge is an intricate bodily sense that has emotional - along with factual - components. It includes emotions, experiences and thoughts which you have had in the past, but it itself is not an emotion. An emotion is often sharp and clearly felt, while gut knowledge is complex and much more difficult to describe. It is a broader, holistic, unclear sense of the whole situation, made of many interwoven strands but felt as one.

This bodily knowing is difficult to access because what we first meet is the emotions - they “spring out”. We can only find the deeper level when our emotions let us through. Then we can sense all that lies below or behind the usual feelings and emotions, we can sense the situation itself. When we find this deeper layer, we can complement our models with our experience. Instead of leaving our experiential edge out of the picture, we can let it inform our decisions.

Developing Your Biological Software

Wholes and how they unfold can be known only intuitively, with one's body, just as one knows the ways of a familiar culture or the ways of a familiar person. The body of an experienced market practitioner knows its environment, it can sense the whole situation - in its concreteness and specificity - as one, in a way that no computer can. It's only from a sense of the whole scene that we can discover new aspects of the environment, factors and relationships that haven't yet been constellated as “facts” by the market. And it's also a bodily sense that allows an experienced investor to instinctively grasp trend formation.

When we have a knowledge of the scene, we are grasping interaction: Interaction among the major players and also how different aspects of markets and different economic processes are interacting. Interacting as intricate wholes. Unlike computer processing, gut knowledge is not made of discrete bits of data that you add together in your mind. It rather comes to you all at once, including all the bits of data you've accumulated in the past in a single - though intricate - bodily sense. It encompasses everything you feel and know about a situation not as the sum of individual static factors but as an unfolding web of interactions. This type of knowledge is not an alternative to science but rather complements it.

How then can we know if a gut feeling expresses a valuable subconscious analysis of the situation rather than a biased emotional reaction? How can we access this intuitive knowledge, how can we let our gut work together with logic? And how can we remain receptive to the state of market psychology without falling ourselves prey to the conventional wisdoms and emotions driving the crowd?

MarketFocusing teaches you how to access and reliably consult the deeper layer of bodily knowing. It is an application for the market situation of a methodology - named Focusing - developed by the philosopher and psychologist Eugene Gendlin, PhD, at the University of Chicago. Beginning with the murky edge of what you know, which can only be sensed physically, it opens up the knowledge that is implicit in your sense of a situation. It connects bodily felt experience with logical understanding. It teaches you how to think with your gut.

In order to reach the deeper layer of bodily knowing, *MarketFocusing* targets the main psychological variable influencing investor and market behavior: confidence.

Calibrating Confidence With MarketFocusing

In the market situation, access to the deeper layer of bodily knowing is hindered by confidence-related biases: overconfidence and lack of confidence. The confidence biases stem from deeply ingrained habitual responses that arise in connection with a low tolerance for uncertainty. There are two basic tendencies that human beings show when the lack of certain knowledge generates an intolerable anxiety. The first habitual tendency is a denial of uncertainty. When we fall prey to it we overlook the fact that we don't know for sure to make it easier to act. The second habitual tendency is that of withdrawing. In this case we remain aware of uncertainty, that is we know that we don't know for sure, but this makes us afraid to act and prone to a premature disengagement. In other words, we collapse.

Normally both tendencies are present: it's as if we have an overconfident, greedy or hopeful "sub-identity" and a fearful one. The first might feel energetic, without a shadow of doubt in mind, eager to act. The second might feel apprehensive, maybe scared to make decisions, worried about outcomes that are out of your control.

Each of the tendencies involves a positive aspect: the motivation to act, on the one hand, and the awareness of uncertainty, on the other hand. Both are needed for optimal decision making under uncertainty. However, a biased participant is under the grip of either one of the habitual tendencies: he identifies himself with one of the sub-identities and exiles the other. There's an inner war going on - but he's unconscious of it, the process is not under his control.

MarketFocusing teaches a person to access each of the habitual tendencies inherent in market participation, and then to have both simultaneously present, without identifying with either. When this happens, the positive aspects of the two tendencies start to work in tandem: she can not only act with an awareness of uncertainty but also, when circumstances so demand, withdraw without experiencing her own fallibility as a threat to herself.

> M., a technical trader whose decisions are mostly discretionary, felt that he missed many opportunities: he'd sometimes get paralyzed, unable to act. He was at first identified with the side of him that is eager to act, that felt like "himself", the other, cautionary side felt like someone else who was in his way and would sometimes take over. As long as he was caught up in this conflict, M. could only sense either what he feared or what he hoped. His bodily feelings were not yet gut knowledge. After 5 sessions of *MarketFocusing*, M. learned how to have both tendencies working together as a team. When this is the case, he knows for sure that he's not under the grip of a habitual emotional bias. He can then trust his bodily signals and listen to what the eager and the cautious sides of him know about the current situation.

With *MarketFocusing*, the person learns to separate her own individual-psychological habitual tendencies and biases from the extraneous uncertainty, that is, from factors that are unpredictable and out of her control. While this does not make the unpredictable predictable, it is highly empowering: it allows the person to reestablish control over variables that are controllable and improves her relationship to uncertainty. As the tolerance for uncertainty increases, so does flexibility and adaptability. The person becomes better able to listen to and trust her own inner sense of rightness and gains the capacity to adequately react to unexpected events.

> After a streak of losses, N. became apprehensive to make decisions where the outcome was outside his control. His bodily feeling was a tightness. Here the conflict was between a wanting to control and a knowing that not only you can't control the market but also that this impetus is itself ineffective in trading. Knowing that he could not rely on his instincts, N. had recourse to an exclusively mechanical trading system. After 6 sessions of *MarketFocusing*, N. had improved his relationship to not knowing: instead of being uptight when he didn't know what to do, when he didn't have the answer, he began to ask: what's the right question to ask. This led him to improve his trading model and reintroduce a discretionary element, where his sense of the market situation comes into his decision-making, adding a contextual variable to the mechanical signals. Now when he feels the tight apprehension, he uses it as a competent guide that leads him to what he needs to be paying attention to.

Most important, with *MarketFocusing* the person finds a great store of information about the situation that was previously not available to her conscious mind. Superimposing the subliminal knowledge contained in each of the tendencies leads to a bias-free assessment of how the two forces are working at the market level. The procedure allows the person to think beyond the conventional wisdoms driving the crowd. It leads to new hypothesis, new questions, new information-gathering and new probes, generating a new kind of information concerning factors that could not have been thought of or isolated before and resulting in better decisions.