TRANSCRIPT OF LECTURE GIVEN AT LINDA BRADFORD-RASCHKE'S LBR-GROUP (25 Mar 2003)
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I'm going to talk about the QUALITATIVE aspect of trading. The role of experience and gut knowledge. What we can do to improve our experiential learning and increase the speed with which we learn. And how we can make our gut feelings RELIABLE, transform them into GUT KNOWLEDGE.

Let me begin by telling you how I got into this work. While I was doing my doctorate in financial economics I realized there was a huge gap in the understanding of market behavior. Uncertainty wasn't taken into account. Everything is about quantifying RISK, nothing about uncertainty. All the academic notions about rationality, both about markets being rational – that is, correctly reflecting fundamentals at all times - and market participants being rational, the whole idea of "rational economic man", assumed uncertainty away. That was the only way they could tell what's rational and what's irrational. But how does that help you, if uncertainty is the rule of the game? The question I asked was then: what does it mean to be rational under uncertainty?

You wouldn't believe it, how far off these academic guys are. Even most behavioral finance people – Brett is an exception. Their idea of how things "should" be only applies to a world where there is no change. A dead world, that is. For instance, take confidence. There's no psychological variable about which there's more consensus among traders than confidence. Academics, too, think of confidence as the most important psychological variable affecting market behavior. But for them, that's subjective stuff, which they see as always irrational. But all traders know that in reality confidence SUPPORTS rationality.

The academic idea of rationality is processing information like a computer. But whatever a computer does is only based in the past. This can only be rational in a world devoid of uncertainty, where things don't change in the future in ways that differ from how they changed in the past. For them, if confidence – or any other subjective factor - plays a role, it's because you're a bad computer. But we are MORE than computers. There's a whole side to our embodied, experiential knowledge that computers don't have. Our bodies "know" the situations we meet in life and how they can unfold. They can feel situations as a whole and also are in touch with the continuity of events in a way that no computer can do.

It's because the world is uncertain that we need this intuitive, gut knowledge. Without uncertainty, analysis alone would do. With uncertainty, rationality needs to be more than that. The question of uncertainty led me to see that intuition is not a matter of being less-than-rational, as economists see it, but rather of being more-than-logical. Intuition (or gut knowledge…whatever you want to call it…) is not some kind of flaky stuff, it's what we need and use to complement logical analysis in an uncertain world. This might sound very obvious to you, who doesn't know that? Well, economists don't. If you ever took an economics class and it made no sense to you, that's why: it doesn't apply to the world as we know it.

No wonder then that I couldn't find anything in the literature about the question that fascinated me most: How professional speculators know what they know. But I was at the economic sciences department, and the question of how we know what we know is not an economic one – it belongs in philosophy and in psychology. So I wrote my thesis on uncertainty, developing a market theory which had uncertainty at its core.

Once I was done with that, I returned to the really interesting question: How is it then that professional speculators know what they know. They tell you they feel the market, smell the market, etc. But how do they go about that? What is actually happening inside them? How do they learn how to do it? And is this a skill that can be taught?

I started to think about the intuition of a pro as parallel to empathy. Empathy is something that we all know from interpersonal relationships. It's the capacity to experience another person's feelings, thoughts or movements. We do this by unconsciously reconstructing the perceived patterns within ourselves. Our bodies track what's going on in the other person, and our own sensations let us know what it's like. For instance, if someone is sad, we feel their sadness by sensing this feeling within ourselves.

Psychotherapists are professional about empathy, they use it professionally, as their tool. They draw inferences about the inner life of the client by sensing themselves. That's what the professional trader does, too, when he intuits the market: the pro has an empathic relationship with the mind of the market. And, just like the therapist, he knows how to separate what he's picking up from his own stuff, he feels what's happening in the mind of the market but doesn't merge with it. So, I thought that the psychotherapists could teach me something that I could transfer to the market situation, and I decided to find out how is it that the psychotherapist learns to do what he does. Guess what? They had no systematic method for teaching and learning this either! Everything was supposed to happen with experience, with time…

So I thought: If what we do with empathy is to sense things within ourselves, then PRACTICES OF AWARENESS would teach you how to do this. My next research project was to study different practices and evaluate them as to what would be most helpful in decision-making under uncertainty, and if and how they could be adapted to the trading situation. I was at the time at UC Berkeley, working with a psychologist who's specialized in embodied cognition, that is, experiential, bodily knowing. I'd then adapt the methodologies and try them out with traders and see what worked and what didn't.

Eventually, I developed my own methodology, MarketFocusing. It's an adaptation for the market situation of the methodology called Focusing, which was what I found most helpful among all the approaches I had looked at. Focusing was created by a philosopher and psychologist, Eugene Gendlin, at the University of Chicago. Gene had a very sophisticated theory of how bodily felt experience and logical reasoning work together. He wanted to test his theory and thought that the right area to do it would be psychotherapy. He did a lot of empirical studies, these studies are considered to be among the most robust findings in clinical psychology. He was able to answer a fundamental question which had been puzzling therapists all along: why is it that some therapies are successful, that is, bring about psychological change, but many others are not? What then is the determining factor?

Gene showed that the people who were successful cases all shared a certain skill: the capacity to think WITH their gut feelings. They had the ability to tap an internal process ignored by most. Right from the beginning, they showed a capacity to attend to the "murky edge" of what they know, which can only be sensed physically. This different kind of inward attention to what is at first sensed unclearly allows people to identify a broad attitude or large issue that underlies specific problems and questions. This proved to be the crucial factor determining psychological change and therapeutic success. Gene then devised a systematic way to teach people this skill, how to access this intuitive level. For me, this was ideal: I could use the method both to help traders access their gut knowledge AND to deal with the psychological issues that were detrimental to performance.

When I met Gene and showed him how I worked, he was totally taken by it, and we've been working together ever since. His theory then helped me fill out the missing pieces of my own theory about how speculators combine analysis and gut feelings. I put it all together in a paper called "How George Soros Knows What He Knows". Soros is of course the ideal instance for me: he has both a highly analytical mind and very sharp instincts. It's often been said that there's a great contradiction in Soros' life. On the one hand, he attributes his success to his conceptual framework – which he calls "The Theory of Reflexivity". On the other hand, people that know him well – like his own son - say that in reality his decisions have nothing to do with reason: he changes his position on the market when his back starts killing him. In my paper, I show that his theory and his use of instinct do not contradict each other. Not only do they complement each other. Soros' theory actually calls for intuitive judgement. And that's how I got to meet Soros: He read the paper, found it very interesting and called me up.

OK, enough background. Let's talk about intuition in trading.

Nobody trades WELL based exclusively on a mechanical system. First of all, mechnical systems only encompass what has BEEN, only the past. Second, they are context independent. They can't take CONTEXT into account.
For instance, a technical formation can unfold in different ways depending upon the context. In the market situation, each moment has its own texture or FEEL. This FEEL of

the moment has information about how a pattern is likely to unfold and it is information that no chart alone can give you.

It was very interesting being in Linda's office today. Today one of her most robust models gave three false signals in a row. And she did not put on a trade. (The trade would have been to short reaction UP after penetration of lower Keltner channel on hourly charts this morning. The chart is posted on the daily educational chart section of the lbr site).
Linda did not make the short trade off the reaction up because her sense of the whole was that there was a misfit between the signals versus her sense of the situation.

What's in this sense of the situation? If you just look at the hourly structure, the signal means something…if you take into account all the different patterns and time frames operating independently, they mean something else. But that's not all: there's this particular moment in history, which is unique, the geopolitical situation, how all the different markets are interacting. Etc. etc. Any situation has infinitely many aspects. This means that no situation can be uniquely represented. That is, no single model – or set of models – can capture everything. But the situation as a whole is something that you can bodily comprehend.

Let me give you an exercise that will make clear how the body KNOWS whether a decision is right.

THINK of TWO decisions you have recently made. Preferably, decisions where the outcome is not out yet, so you do not know whether the result will be favorable or unfavorable. It does not have to be a trading decision. Now one of these decisions should "sit right": when you think about it, it feels right...things may still turn out wrong, but the DECISION feels right, you feel at ease with it, you are comfortable with your decision, even though you do not know the outcome yet. Now, the other decision should be one that "sits wrong".....When you think about it, you wish you had decided differently. Things might still turn out well, but when you think about it, you are still apprehensive…you hare not sure, you are not happy with your decision making process....

So, TAKE some time and think if you can come up with TWO decisions like this. One on each extreme. Could be any decision regarding anything: to go somewhere, marry someone, buy a car, a career decisions, the content doesn't matter. It's even better if you take a non-trading decision at first, we'll get to that later on.

NEXT, leave the decisions aside and sense yourself - how you feel from the inside. Spend a moment sensing yourself from the inside. Sense your feet from the inside…your legs…the pelvic area…your back…shoulders…arms…your hands…. Then sense your head from the inside. And begin paying attention to your breathing… take a moment to sense if one nostril is more open or active than the other side...then follow the air as it goes down the back of your mouth…sense your throat from the inside..your chest…your belly…

Now, dwelling in the central area, sensing your throat, chest and belly from the inside, ask yourself: WHAT is it like, this inner space, what's the QUALITY of this inner space right now? It might be soft and wooly, or wiry or grainy, maybe it is tight or it is spacious. Maybe what you have is a metaphor, such as being at the edge of a cliff or an image...it might have an emotional quality…sense what is it like right now. If you have found good way of describing it, great, if you need more time for it, that is OK...but in any case, make sure that you know what is FEELS like.

NOW Keep listening to this inner sense, and recall the GOOD decision.... And see if you can notice a SLIGHT change, maybe something will loosen up inside you. And now, think of the BAD Decision, the one that doesn't it right, and see how something immediately tightens up. There IS a change in quality...maybe you feel a bit constricted. When Linda did this exercise with me, it felt like there was something dark inside of her...dark and wiry, and she could notice a change in how it felt inside her when she thought of the different decisions.

So, it is very often the case, that we make a decision that looks perfectly reasonable and logical on paper but then something inside of us complains. The decision does not sit right. This means that something about the decision is violating all of our EXPERIENCE. The experience that we have accumulated in the couse of our lives. We often ignore such feelings – and regret it afterwards. When we learn to attend to these bodily feelings, we become able to know whether we're making a good decision not in hindsight but IN ADVANCE. These feelings can guide us into decisions that "sit right". In such cases, even if results turn out to be unfavorable, it will be for reasons that have nothing to do with us and our decision-processes, such "failures" are much easier to take. They never undermine us, and we can quickly react to new developments. Haven't you ever felt, after the unfavorable results of a decision came out, that the WORST of it all was that you'd known it all along?

Yesterday Linda and I talked about "green lights" and "red lights", and how important it is to recognize what they FEEL like. If you attend to what your body feels like, to the various sensations, you'll notice a lot of differences. Try this: Sense your body from the inside like we just did. Then recall a situation where you had a "red light" telling you to get out. Can you feel a change? What's it like? And what happens inside you when you have a "green light" telling you to jump into the market. What's that like? Linda gave a nice description of what getting a green like feels like for her. It was sort of like wheels spinning…or gears spinning around, and you're waiting for them to catch. You can feel them catch…and if the market picks up a firmer bid (if you're looking for buyers to step in), then you FEEL all of a sudden your scenario was correct.

There are also times when you have the sense of just not being in synch with the market. At this times, you're always better off standing aside. What you should do then is shift your mode from "what should I do next?" to "what's the market like right now?". Forget about having to trade and just observe the market. With interested curiosity. Each moment has its own quality or feel. Ask: "What does the market feel like right now?" That will bring you back in sync.

For a beginner, if you try to describe the market,you might just have a very few categories...such as: it is "choppy" or it is trending. As you gain experience, your vocabulary to describe the market expands, and you start to clue in on subtle nuances. Yesterday and today, every once in a while I'd ask Linda to describe how the MARKET feels, and also how SHE was feeling. There was a really interesting point just before your 5 minute bull flag.

Linda was saying: "it is still in a fog, still in the process of developing something....it was developing something, but I could not feel the dance yet...". She felt frustrated but was on guard against doing a trade out of frustration. I kept prodding her, asking her for more detail. She told me it felt like it was a spring that was getting COMPRESSED. I kept pressing her for more detail, and her feel, that was at first ambiguous and mixed with her own frustration, started to turn into concrete information! The fog turned into a spring being compressed, and she told me it was going to turn into big a move...At that point, she told me that the chart looked like a BAD HAIR DAY...and went to check her numbers. This is when she looked at the 60 minute chart that showed that the market was going against the hourly model. She then started to pay more attention to the churning...a sign of building up to having longer term implications. That is, when she started paying attention to the fog, and let go of the pressure to do something and the frustration that comes with it, it turned into a curiosity about what it was telling her.

This is something an unexperienced trader can practice doing in order to speed up the learning curve. Just checking what's the FEEL of the situation right now as opposed to what am I supposed to do. Instead of being under pressure to put on a trade if you have no green light or you don't know....just pay attention to what the market is like and try to describe it. Its quality, its texture, etc. Put it into words. Yesterday at the close, Linda told me the market looked SLOPPY within the context of holding. This morning, the market felt DYNAMIC to her. It felt like there was sand swirling at the bottom of the ocean, poor visibility, as if the market was still digesting...wavy...

I grilled Phantom, too. He said at some point the market was RED, it was NERVY…humid rainy…neither pouring nor drizzling. You can practice that, and do it playfully. You can, for example, think of the market as if it were a type of music. What type of music would it be? Or is it more like a novel, a play, a movie? If it were a food? A girl, what type of personality, how would she be behaving now?

This will add another dimension to just looking at raw bar chart patterns. Let go of the pressure to put on a trade and rather think instead: what does the market feel like? Just for the sake of it. You'll find that your capacity to make distinctions will increase in ways that you never thought about.

Now, you can't be in sync with the market if you're not in sync with yourself. That's when you enter trades not because you have a green light but out of compulsion, or get out not because of a red light but out of fear. We often do not follow our gut feelings because we think they aren't reliable. And the truth is, they are often indeed unreliable, they're biased by our emotionality.

When we first sense ourselves from the inside, it's often a BLUR. It contains our bodily sense of the situation mixed up with our biased emotions. But we can learn how to "clean up" the sense of the situation from our own reactive emotionality.

In the market situation, we are most likely to find habitual patterns which are related to an INTOLERANCE OF UNCERTAINTY. These are reactive patterns that get triggered when uncertainty makes us anxious. You see how closely linked uncertainty and intuition are. On the one hand, it's because of uncertainty that we need our gut knowledge. Otherwise we could let our models do the job, automate everything, and go to the beach. On the other hand, if we can't tolerate uncertainty, our gut feelings will not be trustworthy.

These habitual reactive patterns basically fall into two classes. One is that of DENIAL. We overlook the fact that we don't know for sure. We deny uncertainty – which is the rule of the game. That's the case of an OVERCONFIDENT trader, who then becomes unable to realize the different ways that things might turn out to be.

Another habitual reaction pulls you in the opposite direction. The first tendency pushes you forward, the second one pulls you back. We remain aware of uncertainty but we are AFRAID TO ACT. We panic and withdraw. That's what happens when we lose confidence, in this case we become unable to realize how things might turn out different than what we fear.

In both cases, our vision is narrowed. We are left unprepared for anything that does not correspond to our expectations. These biases hinder us from accessing our TRUE sense of the situation – which is always uncertain in the sense that it's never finished, it's constantly unfolding. And we cannot stay in touch with the way it's unfolding NOW.

We all have both tendencies in ourselves. We all have a pushy part and a cautious part. This is not bad at all, we need them both. Without the pushy part, we'd never be able to pull the trigger. And without the cautious part we'd never keep out of trouble. The problem is when we are taken over by one of them. That's when our motivation degenerates into GREED, and our caution into FEAR.

It's as if inside every trader, there is both an overconfident trader AND a trader suffering from loss of confidence. All traders have bumped into these two sides of themselves. So, how do we avoid merging with them, becoming them?

The first thing to do is to become better acquainted with them. Take one at a time. And ask yourself: What's this part of me like? What am I like when I'm merged with it? You might say: I already know it very well! I wish I'd know it LESS well! But the truth is that you can't wish it away. What you want is to engage its cooperation.

The trick here, the important thing, is to take an attitude of interested curiosity. See yourself as a scientist, who's interested in what he's observing, trying to find out what it's like, what it feels like in your body. And it's a friendly scientist. A scientist who feels empathy with what he's studying knowing he doesn't have to do what it wants.

Say you take the fearful one first. Can you be friendly to it? Acknowledge and welcome it? Say hello to it, as if it was another person, an old friend.

Acknowledging is the first step to neutralize the reactivity. If you try to push it away, it will come back through the back door and guide your behavior. These parts of you that you think you're not supposed to have as a trader – you can't eliminate them by self-talk. Often people who are suffering from a loss of confidence beat themselves up for it. This becomes self-reinforcing, and this is of course a dead-end.

At the moment you say hello to it, you've disidentified with it: you're no longer IT. Then just let it be there if it wants to. The reactive parts of us are not PRESENT, they are doing their own stuff, acting out, instead of being in the NOW, interacting with what's going on out there. Whatever in you lacks presence, PRESENCE is what it needs – and you, as the observer, can give it by being present to IT!

Then take the other side and do the same.

The more we practice, the better we become able to sense the tendencies clearly in the body. We literally feel the push forward and the pull backwards. It's always a bit different from person to person. Most people can feel the fear clearly in their chest and belly, but exactly what it feels like varies from person to person, and it's also not exactly the same all the time. When you say "hello" to it with the right attitude, it always releases a bit, becomes less uncomfortable. But also the greedy part can be felt. A trader I worked with felt it as a dark, tight feeling in his lower back. I myself feel the pull back of the fear more clearly on my right side, and the push forward of the greed on my left. I've once worked with someone that had it the other way around.

Now see how it's possible to just be aware of both of these sides of yourself at the same time. Without identifying with either. You're the interested observer! Observing the greedy, overconfident trader and the fearful one who lacks confidence. If you do this correctly, you'll see how they lose their grip on you. One of them shows up, you say "hello" to it. It might then go away, or just become less intense. If it's still there, use this as a chance to observe it with interested curiosity and find out more about it! Once you listen to it, the other one is likely to show up, too. Once you have both, they can begin to cooperate.

One of the traders I've worked with – he was Australian, we used to have phone sessions - once called this "teambuilding". He had a problem of not pulling the trigger. Then he gave these parts within himself a division of labor. The fearful side watched around the opening…and then it was up to the greedy one to make the trade. Breaking it up into a division of tasks between the two sides ultimately worked for him.

There really is no single part of us that is only bad. The overconfident, greedy one is highly motivated…, we all NEED this side. Same thing with the fearful one: we need its caution. Once we learn how to listen to them, next step is to learn how to inquire; they'll then tell you what you need to be cautious about in a particular situation, and also where opportunities lie. But listening and inquiring in this way is not so easy without having been guided by someone who knows how to do that, most people need some training to get to that point. In any case, acknowledging in a friendly manner is a first step that already can bring you a lot.

Question: Are there gender differences when learning to listen to your self, or is it easier for women than men?

We know there are intuitive men, such as Soros – and Chris, too! - but it is easier for women, who are naturally receptive and also because they are more used to paying attention to their feelings and putting them into words. But men develop gut feel just as well as women.

Men, in turn, are more aggressive, greedier. Women have an easier time listening to themselves, while man are often better at getting things done without hesitating too much.

Question: please expand on getting “fearful” me and "lead with chin" me to balance better. They seem to want to take turns driving!

Yes…that's the problem… we are often taken over by one completely. It's as if they want to take turns being in charge. And the trick is to learn to have both present at the same time. Everything starts with AWARENESS first. We need both sides, but in cooperation, not being ruled by one. So we start by being AWARE of this duality within us. You have both of these sides within you but you are MORE than they are. Also, they should not be pulling at each other, the WHOLE should be greater than the parts.

Basically, you go from "I am afraid" to "I am sensing something afraid inside of me....". Turn it into an object of your attention. The afraid part is not YOU. YOU are the one who looks, you are looking at IT, the afraid part. When you can do this, the other side, the overconfident side, will show up on its own and step in. And the other way around, too.

When you have both sides working in tandem, you can not only act, go ahead with an awareness of uncertainty but also, when circumstances so demand, withdraw without experiencing your own fallibility as a threat to yourself.

Fallibility is a key concept. Soros calls his operating principle “The Belief in Fallibility”. The possibility of being wrong makes most people anxious. We don't like to consider it. Soros, in contrast, is interested in how he's going to be wrong. He knows every hypothesis is flawed, every trade will degenerate. When he has a “green light”, he puts on a trade. But as long as he can only see the positive side, he worries. This worry guides him into searching for the flaw. Once he finds it, then he feels at ease. He’s prepared for it, ahead of the curve. Knowing THAT he’ll be wrong and constantly searching for WHERE and HOW he’ll go wrong gave him a huge edge.

We all tend to want the bad feelings inside ourselves to go away. It’s really important to understand that they are our friends, they can also serve us. Negative feelings inside of you can tell you what is amiss or off....IF you can listen to them...

Last night Linda and I went further and began thinking about degrees and types of feelings of WRONGNESS. When you set up a trade, and it feels bad, you have a “red light”. Can you use this information to say: it felt so bad on the long side, the market is going lower? Can we use it to convert and go the other way, to REVERSE a trade? It’s not that easy. There are different shades of red. And not all failed trades would call for this – these occasions can be rare. But you can pretend you’ve already decided to reverse the trade, without really doing it, and check what that feels like.

Summing up:

1. Pay attention to your bodily reactions, both in the market context and in other contexts. Pay attention to your bodily signals and try to describe them – put them into words.

2. Notice the reactive patterns and welcome them. Observe them like a scientist, that’s how they will lose their grip on you and stop interfering with your sense of the situation.

3. Look for qualities of the market. Once you’ve seen a lot of scared markets, for instance, you can start asking what’s particular about THIS scared market.

All processes require learning, paying attention to yourself and your sense of situations is no different. The good news is that it’s self-reinforcing. Once you start doing it, it will continue to happen on its own, with your having to do less and less about it.