False Certainty and Pursuit of Truth

Paul Saffo, a Professor who teaches forecasting at Stanford, lays out the danger of creating false-certainty and the importance of evaluating multiple outcomes in his excerpt below:

> *The point of forecasting is not to attempt illusory certainty, but to identify the full range of possible outcomes. Try as one might, when one looks into the future, there is no such thing as "complete" information, much less a "complete" forecast. As a consequence, I have found that the fastest way to an effective forecast is often through a sequence of lousy forecasts. Instead of withholding judgment until an exhaustive search for data is complete, I will force myself to make a tentative forecast based on the information available, and then systematically tear it apart, using the insights gained to guide my search for further indicators and information. Iterate the process a few times, and it is surprising how quickly one can get to a useful forecast.*
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> *Since the mid-1980s, my mantra for this process is "strong opinions, weakly held." Allow your intuition to guide you to a conclusion, no matter how imperfect — this is the "strong opinion" part. Then – and this is the "weakly held" part – prove yourself wrong. Engage in creative doubt. Look for information that doesn't fit, or indicators that are pointing in an entirely different direction. Eventually your intuition will kick in and a new hypothesis will emerge out of the rubble, ready to be ruthlessly torn apart once again. You will be surprised by how quickly the sequence of faulty forecasts will deliver you to a useful result.*
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> *This process is equally useful for evaluating an already-final forecast in the face of new information. It sensitizes one to the weak signals of changes coming over the horizon and keeps the hapless forecaster from becoming so attached to their model that reality intrudes too late to make a difference.*
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> *More generally, "strong opinions weakly held" is often a useful default perspective to adopt in the face of any issue fraught with high levels of uncertainty, whether one is*

> *venturing a forecast or not. Try it at a cocktail party the next time a controversial topic comes up; it is an elegant way to discover new insights — and duck that tedious bore who loudly knows nothing but won't change their mind!*

If you find yourself thinking in definitive statements about what the market or a stock is going to do you need to stop and practice some humility or the market is likely to teach you a costly lesson.

In trading we <u>never</u> know all of the important variables and are always flying partly blind. We need to accept this truth and like Saffo says, our analysis needs to be a continuous and iterative process. This keeps our mind amenable and open to new and important information as it comes in.

This open-mindedness and relentless pursuit of what's true is one of the most consistent character traits across amongst the trading greats.

Ray Dalio (most profitable hedge fund manager of all time) remarked on the importance of constantly questioning the strength validity of your thinking here:

> To make money in the markets, you have to think independently and be humble. You have to be an independent thinker because you can't make money agreeing with the consensus view, which is already embedded in the price. Yet whenever you're betting against the consensus, there's a significant probability you're going to be wrong, so you have to be humble.
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> Early in my career I learned this lesson the hard way — through some very painful bad bets. The biggest of these mistakes occurred in 1981–'82, when I became convinced that the U.S. economy was about to fall into a depression. My research had led me to believe that, with the Federal Reserve's tight money policy and lots of debt outstanding, there would be a global wave of debt defaults, and if the Fed tried to handle it by printing money, inflation would accelerate. I was so certain that a depression was coming that I proclaimed it in newspaper columns, on TV, even in testimony to Congress. When Mexico defaulted on its debt in August 1982, I was sure I was right. Boy, was I wrong. What I'd considered improbable was exactly what happened: Fed chairman Paul Volcker's move to lower interest rates and make money and credit available helped jump-start a bull market in stocks and the U.S. economy's greatest ever noninflationary growth period.
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> This episode taught me the importance of always fearing being wrong, no matter how confident I am that I'm right. As a result, I began seeking out the smartest people I could

> find who disagreed with me so that I could understand their reasoning. Only after I fully grasped their points of view could I decide to reject or accept them. By doing this again and again over the years, not only have I increased my chances of being right, but I have also learned a huge amount.
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> There's an art to this process of seeking out thoughtful disagreement. People who are successful at it realize that there is always some probability they might be wrong and that it's worth the effort to consider what others are saying — not simply the others' conclusions, but the reasoning behind them — to be assured that they aren't making a mistake themselves. They approach disagreement with curiosity, not antagonism, and are what I call "open-minded and assertive at the same time." This means that they possess the ability to calmly take in what other people are thinking rather than block it out, and to clearly lay out the reasons why they haven't reached the same conclusion. They are able to listen carefully and objectively to the reasoning behind differing opinions.
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> When most people hear me describe this approach, they typically say, "No problem, I'm open-minded!" But what they really mean is that they're open to being wrong. True open-mindedness is an entirely different mind-set. It is a process of being intensely worried about being wrong and asking questions instead of defending a position. It demands that you get over your ego-driven desire to have whatever answer you happen to have in your head be right. Instead, you need to actively question all of your opinions and seek out the reasoning behind alternative points of view.

Embrace the grey areas and unknowns that are inherent to the complexity of markets. Put your ego aside and doggedly pursue what is true at all cost. Continuously test your assumptions and update your thinking as new information becomes available.