Mental Models And Being Wrong

"The Secret to my success is that I'm always wrong. I'm ALWAYS wrong. And I try to correct my mistakes. That's the secret of my success." - George Soros

The quote above is from a youtube video of George Soros (one of the greatest macro minds ever) being interviewed at Google by Eric Schmidt. They covered a number of topics ranging from terrorism, to what makes for good government, and also Soros' push for open societies.

At one point one of the Googlers asked Soros — rather naively — what his "secret sauce" is for his extraordinary trading success. Without hesitation, Soros said the line above. The people in the audience laughed, thinking the answer glib and that the Palindrome was keeping his cards close.

But Soros wasn't joking, nor playing coy. He was being dead serious. He just revealed in a few words, the "secret" to successful trading.

We've spent years deconstructing the greatest traders and investors and their processes in search of commonalities. And the single trait that each and every one of them possess is a total devotion to truth. This results in not just a willingness to accept when they're wrong… but a fervent devotion to trying to find out when and how they're wrong — they don't get offended when proven wrong, they absolutely relish it!

This is extremely important in trading because you'll be wrong far more than you'll be right. This simple fact is too hard for most to tackle. And it's one of the reasons why markets have such a high turnover rate of players. Just think of all the things you have to get right in order to be really right when you put on a trade.

- Direction
- Entry
- Exits
- Timing
- Position Size
- Potential return
- Drivers
- Correlations

It's not easy. You can be right on the macro direction, but wrong on the shorter time frame. This will screw up your entry and stop placement and result in you getting knocked out of your position. And all before a monster move that confirms your call (painful).

You can be right on direction, timing, and entry, but misjudge the length/sustainability of the move. This will result in a failure to take profits at the right time, only to have the trade round-trip on your ass and hit your original stop (this is even more painful).

You can nail nearly everything. You can get the direction, timing, entry and runway, and make a very profitable trade. But… your original thesis about the drivers behind the trade could end up being completely wrong (these trades are more bearable).

So yep, it's hard. It's very hard to be right as a speculator.

But the great thing about being traders is that unlike politicians, we can be waffling mo-fos. We want to be the ultimate wafflers. We want to always question our judgement and our opinions, while being quick to evolve our thinking through Bayesian analysis when new information comes our way. We have to accept that we're incapable of being perfectly objective and that our brain will subconsciously color our thinking with a host of unhelpful biases and heuristics.

The mentality we're talking about here doesn't mean we should profess total ignorance and flip flop on our market calls after every little price fluctuation… far from it.

It means we need to tirelessly work towards the unattainable goal of perfectly balancing fluidity of opinion and conviction in relation to the mental-models that we employ to evaluate the markets. It's all about finding the sweet spot, the cross-section where the need for informed conviction and fallibility meet.

We call this sweet spot "Druck Town" because we don't know of any other trader who embodies this more than the sultan of swat, Stanley Druckenmiller (who was mentored by Soros). Experience, reflection/reassessment, and more experience is the road that takes us to Druck Town. And a host of mental models is our transportation for getting there.

Here's Charlie Munger on the subject:

> *"Well, the first rule is that you can't really know anything if you just remember isolated facts and try and bang 'em back. If the facts don't hang together on a latticework of theory, you don't have them in a usable form.*
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> *You've got to have models in your head. And you've got to array your experience both vicarious and direct on this latticework of models. You may have noticed students who*

> *just try to remember and pound back what is remembered. Well, they fail in school and in life. You've got to hang experience on a latticework of models in your head.*
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> *What are the models? Well, the first rule is that you've got to have multiple models because if you just have one or two that you're using, the nature of human psychology is such that you'll torture reality so that it fits your models, or at least you'll think it does…*
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> *It's like the old saying, "To the man with only a hammer, every problem looks like a nail." And of course, that's the way the chiropractor goes about practicing medicine. But that's a perfectly disastrous way to think and a perfectly disastrous way to operate in the world. So you've got to have multiple models.*
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> *And the models have to come from multiple disciplines because all the wisdom of the world is not to be found in one little academic department. That's why poetry professors, by and large, are so unwise in a worldly sense. They don't have enough models in their heads. So you've got to have models across a fair array of disciplines.*
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> *You may say, "My God, this is already getting way too tough." But, fortunately, it isn't that tough because 80 or 90 important models will carry about 90% of the freight in making you a worldly wise person. And, of those, only a mere handful really carry very heavy freight."*

A robust latticework of theory, as Munger talks about above, is essential to developing an objective way to view markets. And to let you know when it is time to throw in the towel on your original incorrect assumptions. The failure is not in being wrong, but in not having a mental model in place to objectively determine your opinion on a market.