Taming Your Ego

An old trading partner of Taleb's, a man named Jean-Manuel Rozan, once spent an entire afternoon arguing about the stock market with Soros. Soros was vehemently bearish, and he had an elaborate theory to explain why, which turned out to be entirely wrong. The stock market boomed. Two years later, Rozan ran into Soros at a tennis tournament. "Do you remember our conversation?" Rozan asked. "I recall it very well," Soros replied. "I changed my mind, and made an absolute fortune." He changed his mind! The truest thing about Soros seemed to be what his son Robert had once said:

My father will sit down and give you theories to explain why he does this or that. But I remember seeing it as a kid and thinking, Jesus Christ, at least half of this is bullshit. I mean, you know the reason he changes his position on the market or whatever is because his back starts killing him. It has nothing to do with reason. He literally goes into a spasm, and it's this early warning sign. ~ excerpt from Malcolm Gladwell's *Blowing Up*

Five things. The greatest traders who've ever played the game all possess five distinct qualities. These are:

1. Self-knowledge
2. Competitiveness
3. Discipline
4. Open-mindedness
5. Independent thinking

The excerpt above, about the Palindrome (Soros), displays all of these qualities which Soros possessed in spades. He was notorious for passionately arguing his stance on markets only to flip his opinion — and his positioning — on a dime and go the other way. Druckenmiller, Livermore, Marcus, Dalio, Tudor and on and on, are all masters of these traits.

I was reminded of this recently while listening to a Tim Ferriss podcast with legendary Silicon Valley venture capitalist, Marc Andreessen. The interview is excellent and worth a listen, here's the link. They cover many topics that are applicable to trading/investing as well as talk about the future of tech.

But one of the things that caught my attention was when Andreessen said the following (and I'm paraphrasing here):

> *Top hedge fund managers are some of my favorite people to hang out with… they are the absolute most open-minded group of people I've ever met. If you tell them you think they're wrong, their faces light up… they get excited… and will ask you a million questions because they want to know if and how they're wrong and will quickly change their minds if you convince them so.*

I love this. I have found the same to be true as well. Out of the handful of exceptional traders and fund managers I have met, one of the things that most stands out is their absolute devotion to truth, their open-mindedness and their lack of ego.

Now compare these character traits to those of your average retail investor/trader, financial pundit, FA and so on. Not often do you see someone on finance twitter talk about how wrong they were on a trade or theme or even better someone on CNBC come out and say "wow, my analysis on that company/market was waaaay off…", it just doesn't happen.

This is because obtaining these character traits is really really hard — and painful. Our ego is a powerful and domineering influence and unless we're forced to confront it we will happily let it rule our thinking and decision making processes. The truth is, the vast majority of people will gladly choose unhappiness over uncertainty… because there is nothing more that the ego hates than uncertainty —- and markets are anything but certain.

What makes it even more difficult is that this is a constant journey rather than a destination. You will always be battling your ego and human foibles on your quest to better market returns. The riches go to those who persevere and march forward in the face of difficult and challenging self-reflection and growth.

But what's great about markets is that your P/L overtime will be a direct reflection of how successful you are in your evolution. It is impossible to remain ignorant of one's self and survive, let alone thrive, in the markets over the long-haul.

Perhaps no trader better exemplifies this evolutionary process than Ray Dalio (most successful hedge fund manager of all time). It would be natural to think that someone who's pulled over $60 billion from the markets would be a bit cocky… but in Dalio's case, you couldn't be more wrong. Dalio constantly talks about "his fear of being wrong" and has built one of the most advanced organizations centered around the pursuit of truth through relentless self-examination.

Here's an excerpt from an article Dalio wrote on the subject (emphasis added by me):

> *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.*

> *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.*
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> *This approach comes to life at Bridgewater in our weekly research meetings, in which our experts on various areas openly disagree with one another and explore the pros and cons of alternative views. This is the fastest way to get a good education and enhance decision-making. When everyone agrees and their reasoning makes sense to me, I'm usually in good shape to make a decision. When people continue to disagree and I can't make sense of their reasoning, I know I need to ask more probing questions or get more triangulation from other experts before deciding.*
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> *I want to emphasize that following this process doesn't mean blindly accepting the conclusions of others or adopting rule by referendum. Our CIOs are ultimately responsible for our investment decision-making.* ***But we all make better decisions by maintaining an independent view and the conflicting possibilities in our minds simultaneously, and then trying to resolve the differences. We're always in the place of holding an opinion and simultaneously stress-testing the hell out of it.***
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> *Operating this way just seems like common sense to me. After all, when two people disagree, logic demands that one of them must be wrong. Why wouldn't you want to make sure that that person isn't you?*

I have to tell you that it's extremely difficult to really embody this objective search for truth. It goes against our inherent human nature.

I sometimes feel a bit schizophrenic. Over the years, I have been so wrong soooo many times that I now constantly debate myself on the quality of my opinions. For every market opinion I hold, I can argue *nearly* as persuasively for five different competing outcomes. Once an opinion beats out the others I arrive at the point of having a “strong opinion, weakly held.” And that is the best we can aim for… no more.

And I would be lying if I told you that I’m not affected when I’m proven wrong. I am. My ego can be a son-of-a-bitch and likes to think he’s the greatest thing since sliced bread but that just ain’t always the case. But, because I recognize this flaw in my character I can acknowledge the reaction of my ego while at the same time objectively assessing the situation. This is because I value *truth over pride* and *making money over being right.*

Michael Marcus (a Market Wizard) said, “ I am very open-minded. I am willing to take in information that is difficult to accept emotionally, but which I still recognize to be true.”

The John Hussmans and Zero Hedge readers of the world could benefit from adopting this open way of thinking. The markets are no place for emotions, ideologies, or rigid fixed opinions. We need to remain fluid, adaptive, and humble in our pursuit of alpha… so strive to keep your ego in check.