# Predictions and Asymmetry

There was a lively debate in the Comm Center recently over the merits of forecasting and how to assign confidence levels to such forecast.

Here's my quick take on the subject.

The market moves off stories. These stories are based on both the underlying fundamentals and people's perceptions of the underlying fundamentals.

Our job as traders isn't to try and predict where the market is going (that's a fool's game). Rather, it's to identify areas of potential asymmetry.

We like asymmetric opportunities as traders because they allow us to be wrong a lot, and still make a boatload of money. And that's the key to this game. Finding asymmetric opportunities and also creating them through trade management.

The majority of the time, assets and markets, reflect a wide range of stories (ie, people's perceptions of the underlying fundamentals). This means the market is pricing in a wide range of potential future outcomes. When that's the case, there tends to be little asymmetry in the price — these are trades we don't want to take.

Asymmetry is born when a story becomes popular (ie, consensus) and it prices an asset/market to only reflect a narrow range of future outcomes.

Humans are really bad at predicting the future. Probably why Mark Twain said, "Whenever you find yourself on the side of the majority, it is time to pause and reflect."

This is why it pays to be a contrarian.

The following three things help with identifying asymmetry.

1. **Understand the popular models/beliefs:** Know the popular economic models, theories, and beliefs that people use to assess the market and understand the world. This allows you to get a feel for how the market will react to and interpret certain data and events.
2. **Know the stories:** This is more art than science and it's helped by having a firm grasp on the above. But read constantly, study the headlines, and develop a feel for the stories

that are driving prices. Bruce Kovner calls this “listening to the market.” Dominant stories are actually pretty easy to spot, the problem is is that we’re likely to believe in them too. Stories only become consensus because they’re convincing.

3. **Understand how the economic machine works:** Markets and economies are complex systems. It’s impossible to “know” how things will unfold, which is why prediction is futile. But, even complex systems follow broad based principles. Knowing these first principles and understanding how the economic machine works a little bit better than the average of the market allows us to identify dominant stories predicated on faulty models/beliefs. Market prices based off faulty thinking = mispricings and asymmetry.

So It’s not about trying to predict certain outcomes. It’s about being aware of many potential outcomes. Then comparing these possible futures to what the market is currently pricing in (by understanding the dominant stories) and seeing if there’s asymmetry between the outcome that’s currently priced in and another outcome that we think is just as likely… or maybe that’s less likely but if it came to pass it would force the market to reprice by such a degree that the trade has positive expected value, anyways.

Does that make sense?

It’s a different approach to markets than the way most do it. It’s an inversion of conventional thinking. Most try to predict where the market is going to go and are focused on being right. We compare where the market is, to a range of where it could be, and focus on how we can be wrong a lot but still get paid.

Market Wizard, Ray Dalio, put it best when he said, “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.”