# Shooting Yourself Full of Hormones Won't Make You a Better Trader

## Your Emotions Don't Need to Be Fixed

Plato erred. Reason and emotion are not opposites. Neither is the mind separate from the body. Neuroeconomics is revealing that perception and judgment emerge like a symphony from an electrochemical orchestra that harmonizes the brain and the body. Body-based events like sensing and feeling are forms of intelligence. There's growing scientific evidence for a wildly different view of what it actually means to think, revealing the potential for a vastly untapped source of behavioral alpha.

Did you know that brains, like bodies, literally get tired; that it's really only possible for a human to make a few good decisions in a row? It's called decision-fatigue and it could be turned into alpha by a CIO savvy enough to insist on such measures as intra-day naps and workouts for his or her traders. Strategic breaks offer two distinct behavioral alpha opportunities: puncturing the mental state of overconfidence that arises from a "winner's effect" surge of testosterone, and modulating the volatility induced, cortisol-driven risk aversion recently documented by Cambridge neuroscientist John Coates.

Sadly, the prevailing view on Wall Street right now is that traders should deal with emotions, as they would with physical pain, by numbing it. The stories of traders voluntarily using hormones to alter their moods and perceptions may be overblown, but it's telling that these stories seem plausible at all.

The aforementioned Coates research about the effects of stress on trading, which recently received a bit of ink, determined that when traders are stressed out (measured by their cortisol levels) they tend to be more risk averse. When Captain Obvious called to tell me this, I could only shake my head, knowing that some genius will start thinking about how he can dope up on Xanax when his cortisol bumps as a way of white knuckling through his body's efforts to tell him something useful.

Hormone therapy, or supplements, will only ever work to remove the effects, not the causes, of our emotions. What's worse, the whole notion that emotions are bad for clear thinking denies the truth that emotions are essential for us to interpret the logic of our minds. If you're stressed out and confounded by volatile markets, maybe it's a good idea to increase your risk aversion. It may mean the market drops more in aggregate than it would if everyone were juiced up and ready to grab falling knives, but on an individual level a certain amount of risk aversion can be productive. Similarly, when you finally decide to go big on a trade, your conviction is always going to be a product of your logical perception and emotional certainty of the trade's risk/reward.

Tobias Brosch, a rising star in neuroeconomics and affective neuroscience writes that "Emotion determines how we perceive our world, organize our memory, and make important decisions." Brosch's choice of the verb "determines" makes the case quite clear.

Wall Street's view on emotion—that we should numb it—is archaic. Neuroeconomists understand emotion not as an artifact of evolution, but a key element in assessment of situations. Surprisingly, neuroscience has demonstrated that in order to make a decision, emotion is actually required.

Emotional awareness is also the missing link in many Behavioral Finance recommendations. It's time to rethink trading psychology when Daniel Kahneman, Nobel Laureate and one of the fathers of Behavioral Economics, admits that "I know from experience…my intuitive thinking is just as prone to overconfidence, extreme predictions, and the planning fallacy as it was before I made a study of these issues." The problem is not the intuition, but the retraining that must occur to know the difference between the bodily-based feelings of impulse or intuition.

A growing body of research suggests that embracing, rather than denying, emotion raises one's odds of creating more optimal behaviors. In what I call the "tarantula technique," it turns out that the most effective strategy for dealing with arachnophobia is to talk about what you fear—to verbalize your feelings. And the more negative words the study participants spoke, the better able they were to overcome their fears. When the fearful didn't talk about their fears and instead tried to reason their way out of fear, they didn't fare as well.

Discussing the gamut of feelings resulting from the hormonal response to a winning streak or market meltdown will empower a portfolio manager to execute in a more optimal way. It seems to be that simple.

In the cases of team trading, there is an opportunity to increase profits by incorporating the latest findings regarding the social construction of perception and judgment. There is always a risk of reaching a poor consensus (groupthink) when people share their opinions, but—as Kahneman points out—organizations have more capacity to systematically disrupt biases. What he means is that we can be better at seeing biases in each other if we work at it.

In the brain, an emotion is just data. It's only when feelings become distorted through denial and cognitive smack-downs that they morph into action and become destructive. Organized meetings dealing specifically with emotional biases bring overlooked risks to light. They untangle the errant merger of the hidden forces influencing our behavior. Achieving optimal risk perception lies not in hormone manipulation (which attempts to either stop emotions from happening, or in the case of testosterone, to increase the feelings of confidence), but in the decriminalization of emotion.

Obviously, an "emotions as information" strategy flies in the face of any sort of he-man culture. It takes a sophisticated CIO or CRO who is willing to break with tradition and admit that trading teams have characteristic mistake patterns related to their emotional perceptions.

What we call risk management is actually uncertainty management and it requires a gauge of confidence in our predictions about the unknowable. Ironically, it's our bodies that store our experiential learning and generate our own sense of an intellectual analysis being right, wrong or incomplete.

Decoding emotional, physical and intuitive sensations offers a cutting-edge way to amass behavioral alpha. Silencing our emotions is more like cutting the wire to your trading screen. You can operate on inferior information or you can figure out what it means. I think the choice is pretty obvious. Don't get too stressed out thinking about it.

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*As originally appeared in Absolute Return Magazine, Spring 2014*