



The Mystery of Investing and Trading Intuition

Portfolio managers and traders recognize that some among their crowd have a seemingly outsized talent for predicting the direction of the markets. On one hand, it's common to cobble together good performance through sophisticated risk management risk but the consistently great performers also appear to possess some sort of otherworldly gift for predicting where price will go. The ReThink Group's *Intuition Brain Game* offers a unique and powerful opportunity to practice recognizing these instincts and intuitions - the basis of exceptional market talent and the mysterious "X-factor."

Brain and behavioral research indicate that financial markets only masquerade as numbers games. Like poker, the asset values only take you so far. Winning is a matter of navigating what neuroeconomists call "intentional social risk". As such, the *Intuition Brain Game* leverages classic psychology research into the perception of social meaning.

Exploring the Nature of Trader Intuition at California Institute of Technology

In 2010 *The Journal of Finance* published a startling study by Cal Tech researchers Bruguier, Quartz and Bossaerts. Through brain and behavioral experiments, they demonstrated how social cognition, rather than mathematical and logical reasoning, underlies the otherwise little-understood X-factor in those market participants who can "read the tape." Researchers call this social thinking 'theory of mind', cognitive empathy or mentalizing. This social thinking style appears to be the power behind the exceptional pattern recognition ability that enables great investors and traders to infer accurate meaning from the dance of market price action.

The researchers first ran an experiment to create virtual market data that included intentional buying and selling (which they unfortunately termed as "presence of insiders"). Next, they performed brain scans to identify which parts of the brain were active when individuals subsequently viewed the development of price action in this virtual market. In other words, the researchers took pictures of active human brains as they were thinking about price movement and identified which regions and structures were most involved in contemplating the price movement. Last they ran a third experiment which tested for a correlation in the ability to predict price direction with scores on three traditional tests of social cognition and mathematics.

The findings in this complex experimental design include:

1. Subjects were quite successful (46-78%) at forecasting the direction of price changes.
2. Correct market forecasts correlated with the results from two social cognition tests with the strongest evidence being for the classic Heider-Simmel Theory of Mind assessment discussed below and used as a basis for ReThink's *Intuition Brain Game*.
3. The mathematics test results showed no correlation with the ability to predict market prices.

The Classic Heider-Simmel Experiment of 1944

More than 70 years after Fritz Heider and Marianne Simmel published their now classic study of perception and geographical shapes, their idea remains the most widely referenced investigation of theory of mind. Using only geometric shapes, they determined that almost 100 percent of subjects watching such shapes move impute human meaning and a story to the movements. Even when their shape video played in reverse, all but two of the studies' subjects reported seeing the unfolding of a detailed human story. Or, to use the original language "interpreted the picture as action of animated beings, chiefly of persons". In essence, Heider and Simmel successfully demonstrated that humans tend to perceive the meaning of others' intentions even without seeing their faces or associated emotional expressions.

Investors and traders who consistently and correctly predict others' future needs to buy or sell through observing the speed and rhythm of price change use essentially the same mental facilities of social thinking. If we step back, we recognize that the only thing we really want to know is if another market participant will pay more tomorrow for something we are buying today. Price prediction, no matter what form of analysis a market participant might favor, looks like a numbers game when in fact it's a human perception game.

Conscious or Unconscious Mental Processing?

As academics have become better able to explore brain activity through brain images and other advanced techniques, it's become widely accepted that most of our mental processing occurs below the level of consciousness. The neuroscientist David Eagleman, whose PBS series, *The Brain* (2015) explores his brain research, presented in his book, *Incognito* that "most of what we do. think and feel is *not* under our conscious control. ... The conscious you is the smallest bit of what's transpiring in your brain." He continued,

"Brains are in the business of gathering information and steering behavior appropriately. It doesn't matter whether consciousness is involved in the decision making. And most of the time, it's not."

Hence, investors and traders for the most part don't recognize consciously that they are predicting other market participants' future perceptions when they predict price. They may realize that they talk about the market in terms of people with statements like "who is pounding this bid?" or "they are coming for them now" but the majority of traders rather blithely accept the widespread misperception that their price predictions stem from some sort of probabilistic thinking. Although they often recognize the similarities between poker and trading, generally the human prediction aspect remains underappreciated.

Expert Knowledge, Unconscious Pattern Recognition and Trading Intuition

It's also relatively fashionable to discount the value of unconscious pattern recognition or felt knowledge. Behavioral finance research has convinced us to doubt the type of expert knowledge which we commonly call intuition. Even the word instincts is less objectionable. In contrast however, leading scholars in judgment and decision making say things like: "intuitive thinking underlies the most advanced thinking" (Reyna, 2012).

More sophisticated thinkers rely on the gist or essence of a situation rather than the literal, verbatim recounting of the factors to make choices. They cull the essence of the questions at hand rather than itemize and prioritize each possible outcome. As such this is what the exercise is aimed at, the basic question of which way price might move opposed to a more detailed analysis of all the factors that may be influencing price movement. A market expert who parses their voice of valid and calm intuition (versus energized impulse) taps into the unconscious pattern recognition they have developed through years of watching how markets behave.

The Bottom Line

In summary, playing ReThink's Brain Game gives you the opportunity to practice recognizing the normally unconscious social pattern recognition. At a very minimum, you will learn how to recognize the physical sensation of accurate intuition.

References

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