

# 2 TRADERS

[EP64: A Storm of Stories \(Part 1 of 2\)](#)

**Darren:** So, my whole point is that, if something is really popular and seems successful, then we know that a lot of people are going to get drawn into trading that way and rather than going along with it, should we be looking for opportunities to go against them..

**Announcer:** Two Traders, Darren and Walter, pull back the curtain on profitable trading systems, consistent money management, and profitable psychological triggers. Welcome to the Two Traders Podcast.

**Walter:** Welcome to the Two Traders Podcast. Walter here and Darren. Today, Darren, we will talk about a really interesting topic that may not seem related to trading at first glance. What are we going to talk about today?

**Darren:** We are going to talk about -- well, the idea comes from a book, from Jonathan Gottschall who's written a book called "The Storytelling Animal". Basically, the book is about human beings and how we cannot really operate without a story.

I've got a little excerpt from the book here that I want to read and it explains it better than I could. He says:

*"... Human beings lived inside the storm of stories. We live in stories all day long, we dream in stories all night long. Stories of how we communicate with each other is how we connect with each other, how we learn, how we think. Without stories to organize your experience on earth, you'd experience your life as a blooming, buzzing confusion. It would all be sound in fury, it would signify nothing, stories you picked with us, story is powerful. Nothing in human experience rivets attention, hooks human attention, and holds human attention like a story".*

When you think about it, you realize that it's true. We, basically, to get some sort of order out of the chaos of life, we have to have a narrative story to everything we do.

Now, obviously, we're here talking about trading. So, what are the parallels with trading? I always like to think about this: why are people trading the way that they do? Why there's so many people trade in a same way?

When I think about trading, I think of it as being random chaos. Why am I always fascinated by the fact that most people are drawn to a small, few techniques to trade?

Obviously, it's -- not obviously but -- my gut feeling is that it's the story behind how they're trading that sometimes trumps the real facts, statistics and probabilities. As an example, let's talk about technical analysis. When scientists -- or experts or whatever you want to call them -- have tried to prove technical analysis has an edge or not, they've always either failed to prove it or being undecided.

It still remains, if not the most, one of the most popular ways of trading. The question is most of us know that fact then why is it that we're drawn to trading that way? I want to stress, I am not saying that you can't use technical analysis and be really successful.

What I am trying to get to the bottom of it here is, what draws us to make the decisions to use those tools? How can we understand that process to be better traders? If we consider, say, a head and shoulders pattern as an example.

When someone explains to you how a head and shoulders pattern works, it's like really clear narrative in a story and it's easy to follow. It's compelling. You can see why because we love the story process, the traders would believe that's the good way to trade.

So, the question is how can we, knowing this, use it to make better decisions? What is your feeling on it?

**Walter:** A couple of things pop up when you bring this up. For me, when I think about academics who study the markets, the only ones that I know who really ever made money out of the deal -- I mean, there are very few that I know of.

There was a book called "The Predictors" that I can post in the shownotes here for those who are interested. That was a bunch of Physicists that got together and figured out how to make money out of the markets.

There was a guy in the "Market Wizard" who is Richard Dennis's trading partner, William Eckhardt, who also... I don't think he technically got his PhD. I think he dropped out before because he got into trading the trend before that and was working with Richard Dennis but he also presumably made money out of the market.

Most of these people, when you asked them -- like for example Benoit Mandelbrot. You know who that is right, Darren? The Chaos Guy. Benoit Mandelbrot, was a Mathematician closely associated with chaos theory and he wrote a book called "The (Mis)Behavior of Markets."

The only reason I bring it up is what we tend to see from the academics is this point of view that there isn't really much you can do in terms of the markets. If you win or lose, it's just luck and it's not likely that you can find really an edge to do much of anything and that is their bent.

From my point of view, what normally will happen is you get these dominant theories in any field. It does not matter if you are talking about Physics or Psychology or Political Science, it's just doesn't really matter.

In any field, these dominant points of view and anyone who comes out from another angle from some weird spot is looked at as an outcast. In the end, these people who are on the wrong side of the fence, unless they're very prolific and worked very hard, they are essentially ostracised from their community.

I'll give you an example. If you are thinking of in Psychology, a lot of Psychologist will study things like PTSD, Post Traumatic Stress Disorder. You came back from Iraq, as a soldier you are messed up and these sorts of things.

There's grant money for that so it encourages people to go along that path. But, I'll tell you what, if you as a psychologist wanted to study people who claimed to be abducted by aliens, there is no grant money for that. You will get nothing published and all of your colleagues will look at you like you are an idiot yet, we have all of these people who claimed that this has happened to them.

This is what happens, I think in, academia. I am not saying that what the author claims about the story is not true. In fact, the other side of that is keeping the alien threat here. I don't think we'll be talking about that today.

If you look throughout history, Darren, what is true is every single ancient culture has a story. The story is very similar and the story goes along the lines of something, about we were created from these people that came from the stars.

What we've done is because of the dominant theory of Darwinian Evolution or whatever, we do not have any theories about how humans came about, about people from the stars coming and creating us.

Even though every single culture, if you'll look from Africa to Asia, has the same story which is we were created by these people, these Gods or, how do you want to say it, who came from the stars.

I mean, the American-Indians have the same story, the Africans have the same story, the Indians have the same story. Everyone has the same story and yet, they are all written off as myth universally.

I find it is a great context to look at things in terms of story. I remember as a young kid, I was in a school bus and we are going on some sort of a field trip. A friend of mine was sitting behind me. He was a big, jolly guy. He was in a seat behind me -- you know in a school bus you can fit like two or three across -- he was sitting there and he had all these people around, in the nearby seats. They were just locked into him, listening to him telling a story.

I remember thinking to myself, "That is really cool that he can tell stories like this and that people are so interested. I really wish I could learn how to do that". I remember thinking that, consciously thinking "You know what? That was just a cool skill to have. To be able to tell a story in a way that locks people in".

I think that you are right, that there's something universal about that. Our cognitive biases probably also encourage that. For example, things like confirmation bias where you look for things that only fit your point of view.

If I've got this theory that the aliens came from outer space and created humans, or at least, manipulated the DNA in a certain way or something like that, then I'm going to look for evidence for that. You know what I mean?

Like that's what I'm going to do. I'll look for all the evidence that I can find and disregard the other stuff. I suppose that really would fit nicely in with storytelling, wouldn't it? Where you would make this story "Yeah, with all the pieces of the story, we've come from those things", that fit your confirmation bias, your over-enlarged theme.

**Darren:** Yeah. But does that mean, basically, if you are starting out as a trader now there will be dominant theories and that's what you are most likely to hear first or most often so you are most likely to end up trading in one of those styles. Is that something that we should go with or is it something that we should try and be contrarian?

**Walter:** Yeah, it's definitely going to come down to your point of view. I mean, if you go out and talk to traditional private funds, many of them -- in fact, I would argue that majority of them -- they take a fundamental point of view.

There are some funds that run algos and all that, like the one the Physicist that started that fund in the book "The Predictors" which I'll link up in the shownotes. The majority of them, if you talk to them, what they would tell you is and I am talking from George Soros across the board and Warren Buffet, most of them have this idea.

That idea leads to certain trades that they'll take a certain positions that they'll take whether it's buying up companies or selling Euros or whatever it is and writing options and things like that, it comes from an idea.

If you ask them, a lot of them won't even use technical analysis to enter into these trades. They could presumably save millions of dollars if they would just have one person to consult with, assuming that technical analysis works, but you know, if they could consult to time their entries. But, they do not even do that.

They do not even consider that. Instead, they have this idea, they put their money where their idea is and then they wait. That is the normal way of doing it. The same thing at the banks.

If you talk to bank traders, they would tell you that even though if they trade some a technical point of view, most of the time they have to give a reason to their boss which is fundamental. "This is why I am buying the JPY, because of this..", "This is why I'm selling the GBP".

It's fascinating because that is sort of the fundamental analysis, dominant theme and they look at technical. I know it sounds funny to a lot of people who trade from home because our dominant story is that, if you want to make money you must use moving averages and Stochastics or whatever, or MACD or whatever.

That is our dominant, but not the case in every domain. I just find it fascinating how it changes depending on where you go.

**Darren:** Is that because the story with the fundamental approach is more complex than the notion of being able to look at a chart and simply read it? Read price action, isn't it just that retail traders were lazy basically and that story is much easier, more comfortable for us than the story of you have to take all this complex information in and come up with your trade idea that way?

**Walter:** I think you are onto something, Darren, because the number one comment that I get from non-traders when you tell them that you trade -- I'm talking about rather sophisticated. I have a lot of friends who were retired, much older than I, and sort of like mentors and some of them will... They've got money and they double in the stock market or whatever, in the US stock market or the Australian Stock market.

One of the big things that they say when we talk about trading is, the assumption is that, I must keep on top of all of the fundamental news and all that. "How you keep on top for that? I wouldn't be able to do that, I wouldn't understand all that".

That is their bent on it, their take, because the assumptions is that you must know all of these things about fundamentals and how fundamental analysis, how to do that to make money.

I think it comes from school. What happens is you learn this, like if you go and become an economics major in any western institution, they're not going to teach you trendlines and things like that. They are more likely to teach you some story about how the interest rates make the world go round or why is CPO, and CPI, and jobs report... You know what I mean?

That's the thing that they are going to teach you is that Central Bank rules and charters and how the ECB differs from the RBA and blah, blah, blah. That is the story that you get. I guess that makes sense to me in a way that it would carry true to those people who are working in traditional finance careers at banks and private funds.

That is my point of view and I think you are right. The other side of that coin is exactly what you say, Darren, which is, so the Ma and Pa of trader. The 57 year old guy who is at home and trading the EUR through his retail trading platform thinks to himself "Self, I can't be as smart as the guy who's got his Economics degree from Harvard. I am just going to have to do something different which is just trade the charts and trade the MACD or trade moving average", that sort of thing.

I think that is kind of his "out" in a sense is to trade in that way. That is the way that I see it and I don't know if that is true but that is how I see it.

**Darren:** I think it's right. The strange thing is I imagined this funds and traders with the techniques and ideas they are coming up with will be less about pouring through economic figures. I imagined they are probably be used in a lot more feel rather than any sort of strict strategy about when the interest rate is X in the cut detour is blah, blah, blah.

I think they probably just got a more use, more of an element of feel in their trading and that is something that you can end up with from starting out from a technical point of view, anyway.

**Walter:** Absolutely. I think you're right. If you talk to some of these traders who are in traditional finance roles, out of fund or out of bank, they'll tell you that they have information overload. They have analyst who are sending them reports on the end. What they really have to learn is to weed out information and put blinders on.

So, you are right. I think confirmation bias plays into it. If you talk to the trader who is running a fund and the fund has a certain idea, they are going to look at evidence and reports that supports their idea. They are often going to disregard or discount those inevitable reports that they are going to come across. Those articles and stuff which is not the same, it doesn't fit the story because confirmation bias makes that happen.

I'll tell you an interesting story, it just happened to me yesterday. I really have a good friend that I go surfing with. He is a very well-established financial journalist. He's been doing this for decades, much longer than I've ever been trading.

You know what he tells me? Because I've been asking, my question was I was trying to get him to tell me if there are any stories that are basically off limits. That when he start to go down a certain path, his editor comes in and says... By the way, his articles

go around the world. He works for a company, I am not going to say which one but their story is picked up around the world. He is on TV when they talk about the economy or whatever, different things. He's been doing this for a long time.

I said to him "Is there anything you cannot talk about?" You start to go down this path -- and I've got the conspiracy bent so I'm thinking is there anything, like in terms of alternative energy that the oil company has stopped him from. You know what I mean? That sort of thing that is off limits, you can't talk about cars that run on air or whatever, on water or something like that.

That was my thinking and then what happened was I was like -- and I was waiting for this -- what is he going to tell me? What is he going to tell me? You know what he tells me? He says "The biggest thing is we'll get this story that comes in from, say, like Goldman Sachs".

This is the example he used, Goldman Sachs comes up with this story about say, gold. They'll send him some information about a gold -- I don't know if you've heard this before, I've heard this before he mentioned it -- but then, one of the stories about gold, Darren, is that the wedding season in India can affect the gold price.

Have you heard this before?

**Darren:** Yeah, definitely.

**Walter:** The first time I heard about this I thought this is crazy. The story is, in India, the wedding season is, basically, I think around August through October or something like that -- includes September I think.

A lot of people in India get married and one of the things that they get gifted is gold. Gold is a pretty common wedding gift over there. There's so many people in India, it can really affect the price of gold because so many people are buying gold at this time of the year as wedding gifts.

And so, he said Goldman Sachs will send them a story and say "Look, you should really be running this" Do you know why Goldman Sach is sending them the story about how gold is going to go up and wants them to pick up the story and send it out to all the wires and everything?

The reason why Goldman Sach wants to do that is because Goldman Sach wants to sell gold and Goldman Sach wants to run the gold price up, and then take it down. That is what they do. That is one of the things that I am so concerned about.

I know this goes on. If I am going to become a fundamental analysis trader, how do I know that the story that is written by Bank of America or whoever Goldman Sachs that I'm reading, their expert analysis that the gold price is going to go up. How do I know that they are not just pumping it up to dump it on me?

You know what I mean? Here I have a financial journalist and he says that is one of the biggest thing that happens to him all the time is trying to weed out this crap story with these brokers who are trying to run things up or push things down so that they can get a better price and go the opposite.

I just thought that was fascinating for somebody who is trying to use fundamental analysis or create a story in your head about where the markets are going. I think it is tricky.

The reason why I think it's tricky is because you have to be careful about how you're going to do this. I don't know how to do it, I guess is what I am saying. I do not know how you can do this.

**Darren:** It's the point that I am trying to make. The dominant story however you trade, fundamentally or technically, is to best avoid it because that is open for people to speculate and take advantage of that. People with more money, smarter people with more money can see that that is the dominant story.

People are going to get sapped into that and therein lies the big opportunity. Like, when you are talking about the way you look at the balance between shorts and long, so when it gets stretched to one extreme, that is the good time to be trading.

When there is a dominant story in control then, you want to be looking to being contrarian towards that. My whole point is that if something is really popular and seems successful then, we know that a lot of people are going to get drawn into trading that way and rather than going along with it, should we be looking for opportunities to go against them.

**Walter:** Absolutely.

**Darren:** Do you see what I mean?

**Walter:** Yeah, totally. To me that's a no brainer. I think you are right. The point is, let's take a step back, what happens in the markets? We know that most people in the markets do not make money even if a lot of people make a lot of money for a certain time. It does not matter if you are talking about beany babies or Malibu homes.

What generally will happen is a very few, a very small minority in any market, whether it's Apple stock or Euros or whatever, a very small slice of the overall market makes the lion share of the money.

What are they doing? Well, they are doing something different. They are not doing what everyone else does. So if everyone says, "It's a no brainer to buy Apple stock" and if you see that 99.8% of the traders are buying Apple stock, maybe it is not going to go "Who else can come in and buy it?"

These are the sorts of things. I think you are absolutely right. That is the way I look at it and I can put the link in the **shownotes** here, if you want a video on this idea and how to find these data. The idea is exactly that with what Darren just said which is "Look, if everybody is doing one thing -- almost everybody is doing one thing and we know that almost everybody is going to lose consistently or ultimately and we want to make money.

Maybe we should do what not very many people are doing. To me, that is a pretty simple approach. It's difficult to do because everyone looks at you like you have three eyes and say "You are crazy. Why would you do that now?", "That's dumb, everyone is buying Apple stock now" or whatever., "Of course the EUR is going to go up".

These are the sorts of things that you have to fight which means that you are reading the newspaper, reading the financial news, watching the financial channels. All of that is going to point you probably, most likely, in the wrong direction.

They will put contrarians on there occasionally but it's not normal. If you sit and watch any of these financial channels, Sky News or Bloomberg or whatever it is, you'll hear a lot of the same story just in slightly different terms.

Then, occasionally, just to make it interesting they'll throw someone up there who can completely disagree with everyone. That is not normally the case. I find it fascinating...

That's it for Part One. In Part Two, you will find out all about lucky football jerseys and how this relates to your trading, picking a lotto numbers and what this means to system traders who Darren wants to sit down with and why sitting down with this person may help out his trading quite a bit.

You will hear my story about Michelangelo and the fund trader's secret to success which is completely very obvious and simple. Finally, why are your friends better people than complete strangers and what this thinking mistake means for your trading.

All these in Part Two, see you next time.