TAYB 006 – Managing Uncertainty

Steve: [00:00] Hello, I'm Steve Ward and welcome to Trade at your Best. In these podcasts, I'll be drawing on research and practice from the fields of Psychology, Physiology, Neuroscience, and peak performance combined with my own experience of working with thousands of traders at institutions across the globe. To provide you with knowledge, insights and practical strategies that I hope will help you to trade at your best and achieve your trading potential.

[00:38] In this episode, we're going to be thinking about uncertainty, which is one of the central challenges along with risk-taking to trade as decision making, and I'm going to be giving you a few suggested strategies for how you can manage it. Let's start just with an example. So I want you to imagine now that in front of you there are two boxes, one on your left and one on your right. Each box has got one hundred balls in it and those balls are blue and red, so some of the balls are blue, some of the balls are red and in the box on your left-hand side, fifty of the balls are red and fifty of the balls are blue. So one hundred balls, fifty red, fifty blue in the box on your left. On your right-hand side, there's a box of one hundred balls they're red and they're blue, but you don't know how many are red and you don't know how many are blue.

[01:39] And here's the challenge and you can imagine there's a prize for this of your choosing, but imagine the task is this. First of all, you have to choose a color of ball to try and select from the box also you can't see inside the box, so you're going to put your hand in blind. You can't see you've chosen either red or blue and then you can choose which box do you want to try and select from. So you could choose to select from the box on your left where you know it's fifty red and fifty blue or you could select from the box on your right where they're red and they're blue, but you don't know the quantities.

[02:14] So it might be interesting to ask people which color ball they went for was it red or was it blue, but that's the least interesting of the two possible questions. The most interesting and the relevant question is, which box would you choose to select from? Would you go for the box on your left, fifty/fifty or the box on your right. Now again I've asked this question to many people in many different workshops all over the world and I often ask people what do you think most people would do? And by far the most popular answer is the fifty/fifty box.

[02:51] The majority of people whether they choose red or blue will go for the box where it's fifty red and fifty blue, and the reason why when we ask people why did you choose that box? It's because they know what the quantities are, so we've got certainty. There might be a significantly greater chance of you selecting your color ball from the box on your right with the unknown distribution, but you just don't know what it is so there's uncertainty. And what it does is people are averse to uncertainty, to ambiguity so it drives this desire to have things that are more certain. Therefore the box on the left, so that's pretty interesting.

[03:37] What's also very interesting for me is the fact that probably for most people, trading is much more like working with the box on your right. Where there are many times, if not for many people all of the time we don't know what the probabilities exactly are. We're working in a world of uncertainty and at the same time as we are obviously having to work in that world there's a part of us psychologically which is kind of craving that certainty and this is where people may be using modeling or where we're looking at to try and get into the numbers behind trading. Essentially part of that process is we're trying to manage the feeling of discomfort that's coming from the uncertainty and kind of putting the numbers on it creates a feeling of certainty. It reduces that discomfort.

[04:31] To be successful in trading much as you have to be comfortable with risk and therefore with losses as we touched on in the last episode, you also need to become comfortable with uncertainty. It's inherently a part of the trading environment and it's also why trading decisions can be so difficult. Once you put risk and uncertainty together and you ask people to make financial decisions, it's complex and it's challenging and maybe that's a large part of the reason why so few people are successful in trading. When there's uncertainty in the market, but also in life we often will experience that through sensations in the body as discomfort and we might label those sensations emotionally as anxiety.

[05:21] So anxiety is often very strongly linked to uncertainty and so it's no surprise that certainly in my work as a coach, with traders, we are talking a lot about stresses and anxieties. They are a normal part of the experience based on the nature of the role that traders are in. An interesting paradox that I often bring up with clients is the fact that we talk a lot about uncertainty and the challenges of uncertainty and sometimes the discomfort and the emotions that it brings, yet on the flip side uncertainty which many people find uncomfortable could also be viewed through a different set of lenses as variety that things are never the same, and actually that's appealing to many traders.

[06:09] A lot of traders like trading because it's not the same all the time so they like the variety, they're just not as keen when that variety is framed as uncertainty, so that's pretty interesting. But here's the thing that's definitely true, uncertainty is going to be a part of the trading experience, it's the way the markets are and therefore the anxieties that come with that and the discomfort are part of that too and you can't get rid of them so they're there, but you can learn to manage them.

[06:40] I wanted to share with you, I guess three different layers of strategies that you could apply depending on where you're at now and what might be most useful for you, but I think the first one is about embracing or about accepting the fact that there is uncertainty and not wishing that it was different or hoping for it to be different, but just accepting that that is a fundamental feature of the markets is uncertainty. Sometimes it's higher and sometimes it's lower, but accepting it is there and I think also with that comes an allowing of the sensations in the body, the emotions, the anxieties that might come with that.

[07:22] And again, and I've touched on this previously and I will do probably in the future because I think it's quite a key piece, but if you view that experience as a negative, then you become more aversive to it. If you're able to view maybe those anxieties or those worries that are linked to the uncertainty as just a normal part of your experience, then you will reduce the impact that it has on you so by framing it as a normal experience as opposed to a negative one, just that alone can be really, really helpful.

[07:57] Secondly, mindset. So uncertainty is a perception to a degree, it's an interpretation and many different traders could all experience the same market and they could all be highly uncertain yet how they're responding to that emotionally and behaviorally could be very different, yet the events they are experiencing are the same. The responses are different and why is that mindset. How am I perceiving that? So I think a couple of things around mindset are interesting to quickly share. One is, and I picked this up from some trading I did many years ago, I think I was on a mindfulness type based course and they were talking about the concept of impermanence and as soon as I heard it and they were explaining I thought, this is really important for my clients in trade and to really be thinking about, impermanence.

[08:55] And what it means is that everything's constantly changing nothing ever stays the same so nothing that's good is good forever and likewise nothing that is bad is bad forever, everything's in this constant state of changing. You're changing over time, the markets are changing over time. The world is changing over time and I think by being able to, in terms of your mental framework, being able to have that as a part of your filtering system, just recognizing almost accepted there is this constant changing. There is a constant uncertainty, neither good nor bad, but it just is, can be really powerful and there's a great I guess it's an ancient piece of wisdom Hereclitis who talked about how when a man steps into a river for the second time, so into the same river for a second time, it's neither the same man and it's neither the same river.

[09:56] Obviously, the river has changed between the first time and the second time and the man will have changed between the first time and the second time, and I think that's in a way how the markets are. When you're trading one day and then you trade again on another day, maybe the next day or the next week or the next month, you won't be the same person because you will have learned new things, had new experiences and you will have adapted and changed even if only in small ways and of course the markets will be different the second time to the first time.

[10:26] So I think if at an underlying level you can kind of build that sense of impermanence in and really start to embrace that I think it's really powerful as it relates to uncertainty, and then I think the other piece around mindset actually, and this often comes out in workshops that the clients kind of give as perspective, is that it can be easy for some people to see uncertainty as a negative, so the framing the lenses they look at that with is this is bad. Uncertainty is bad, it's a threat, it's a negative and if you look at it with those lenses, then you'll get that response in the body. You'll get the challenging emotions, you'll get the discomfort, maybe the stress response kicks in and it will affect your behavior.

[11:14] And what often gets pointed out in workshops and I really like this when clients are able to do this is actually when the markets are highly uncertain, can often be also the time when there's the greatest opportunity and I think that's powerful because you're not changing anything in the market, but that's a reframe, that's looking at the same thing in a different way. Changing perception, reframing, mental flexibility it's a really powerful skill so I think, again if you are somebody who has challenges with uncertainty, if you can start to embrace it, normalize it, that's really powerful. If you can begin to recognize the impermanence of the market and of yourself, that can be really powerful. If you are able to reframe and look at what's good about uncertainty? What could I learn during this period of uncertainty? How could I gain in some way? They're great questions to switch perception that you could use.

[12:22] And then I think if we go to the behavioral level I think there's a couple of really good strategies that you can build into your trading process that can help with uncertainty, and I kind of frame these as techniques that focused on planned uncertainty and I know there's a bit of a conflict there, but uncertainty part of it is obviously is the unknown, that's where people feel the discomfort. So these two techniques are really focused around taking out some of the unknown. You can't remove everything for sure, but you can certainly uncover some things that might otherwise catch you out, so what am I talking about here? I'm really talking about is it possible in the planning and preparation stages to start to think ahead and to start to in advance be aware of all the different possibilities that may be coming your way. So it's really, I think about looking at possibilities, possibly even probabilities to try to essentially create a bit more comfort with the feeling of the unknown.

[13:30] So two quick techniques that you can have a play around with. The first one is one that was very common when I was working in Sports Psych and it's basically if-then scenarios,so the idea is you've got the trading day or the trading week or the months coming ahead, whatever your timeframe is and you've got a trade idea which you're going to execute in the markets at some stage. And some people fall into the trap of this is the trade I want to make, this is how I want it to work. I'm going to enter here. The trades going to run like this, there's an exit and it could be a profit target and a stop loss for simplicity. They're kind of got a one-way plan and the reality is even over short time frames of trading many things can happen. The markets are dynamic, so things can shift and change.

[14:17] So the idea of the if-then scenario is to pre-execution start to be thinking about what are all the possibilities of what could happen in the markets as relate to the trade that I'm about to put on. So that's a great start already because what we're now doing is you are acknowledging that there are multiple possibilities. It hasn't got to be hundreds, but I think in a really focused around some of the key things that are possible. Already by doing that there's an acceptance that there are multiple different possibilities. As you think through them there's also a little dose of exposure to them, which I think is really useful at a stress response level, but I think the next stage is the then piece.

[15:03] So if this happens and if the data comes out and it's above expected or as expected or below expected, what might the market do, and then how will I respond to that? So there's an if, what might happen and there's a then what I will do in that situation, and this is a really powerful technique to decide it around scenario planning and I've used it with a lot of traders. Had a client I was working with last year and this for him and again a trader probably quite anxious by nature, quite risk-averse probably gets caught up in the anxiety and the stress is quite easy in his trading, caught off guard sometimes so I think no, the idea of a bit more focused on the planning and the preparation.

[15:46] Looking at the possibilities, looking at the if this happens then I'm going to do this really helped him both in advance to proceed in a different state but also to be more responsive and less reactive when things happen that would typically would have thrown him off guard and I think that's the other beauty of the if-then scenario is if they should play out, when they do play out you'll get a lower stress response and you'll be able to respond more effectively and be a little bit less reactive, which is really powerful. So that's the if-then scenario planning, really powerful.

[16:28] A slightly different twist on the same thing is a technique called the premortem and this came from a guy I believe called Gary Klein in the US and Neuro-Scientist and Decision Researcher, and what he recognized was that typically, people, they'll make a decision and if the decision has a bad outcome, they'll do a post mortem. They'll work out why it didn't work and so what Klein did was he said, "Well hang on at that point, it's a bit late. It's happened and now we're into reflection and learning, but what about if we did the post-mortem at the beginning, yet i.e it's the pre-mortem." So let me talk you through the processes so you can see how it works. It's a really interesting one.

[17:10] So what you do is you've got the trade that you are looking to make and pre-execution you do the pre-mortem. So here's the first stage. You're currently in the present and so the first stage of the postmortem is you envisage the timeframe at which point the trade may have played out and you imagine that it hasn't worked out. So imagine the trade hasn't worked out. It's a losing trade and let's say it's maybe three months in the future. You then take yourself into that imagined future, so you're now mentally three months in the future at the point when the trade hasn't worked out. From this future perspective, you now ask yourself, what are all the reasons why the trade hasn't worked out?

[18:04] Give yourself time to reflect. Note down all those reasons. Once you've done that you then come back into the present day and you bring those insights with you. Now you're in a position to look at those insights from the future and to be able to use them in terms of any action that's required now before you put your trade on and it's a process that's really called perspective hindsight so it's quite powerful. And people say, "Well, what's the difference Steve, between doing that and me just in the present day going what might go wrong?' And the key difference is where we are kind of on our mental timeline. When you put yourself into the imagined future and ask what has gone wrong, the way that the brain is processing information and the insights you get are very different to in the present day of trying to predict and forecast going forward.

[19:05] So it's something I really encourage you to play around with and give it a go. It's a very, very popular technique in investment management becoming more increasingly popular. I even used it with a client a few years back who was having or his perception was that he was missing out on opportunities in the market, and so what we did was said all right okay let's at the start of the day, let's do a postmortem, sorry, let's do a premortem around missing out. And so what we did was said right, the start of the day, come in, present moment, take yourself and imagine it's the end of the trading day and imagine you've missed out on some opportunities in the markets.

[19:49] Write down all the reasons why you've missed out. With that information now from the future as such, come back into the present, have a look at those insights and see if there's any action you need to take or things to be aware of now as you go through the trading day. And that was immensely powerful, and again, just quickly, one thing I'll just stress because I get asked this in the workshops is, "Isn't this a bit negative Steve, we're kind of imagining that it's gone wrong?" and it's not at all.

[20:22] What we're doing is both with the if-then and with the premortem is we're getting a sense of what might go wrong, but in both cases, we're looking at insights and actions that we can take either in the moment or before to improve our decision making and our performance. So uncertainty is a part of the trading experience. The anxiety that comes with it that may be normal for most of us as we experience that uncertainty at different levels. What can we do? We can embrace it that there is uncertainty.

[20:55] We can think about impermanence and we can kind of adopt that into our mental framework. Nothing stays the same. Everything's constantly changing, that can be powerful. We can change our perception. How could uncertainty be an opportunity as opposed to a threat? And then at the behavioral level the if-then scenarios and the pre-mortem are great techniques around planned uncertainty.

[21:26] The focus of these podcasts is to help you to improve your trading performance, to become a better trader, to move closer to achieving your trading potential. Improving performance requires taking action so I'd like to invite you to take a few moments to reflect on the contents of this podcast episode. To think about what was interesting for you. What resonated and caught your attention and to consider how you might apply it within your own trading.

[22:01] Thank you for listening to this episode of Trade at your Best. I hope you enjoyed it and found it useful. If you've got any questions or feedback about this episode or suggestions for future ones, then please get in touch through the podcast page, www.tradeatyourbest.com. This is also where you can find any links or resources mentioned in or related to this episode and if you'd like to find out more about me and the work I do helping my trading, investing and banking clients to perform at their best, then please visit the Performance Edge Consulting website,

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