Black Swan Capital

Currency Currents

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Key News

- European consumer spending rose for the first time in more than a year (Bloomberg)

- China is reversing some market-opening reforms amid the global economic crisis and raising new barriers to foreign computer services and other companies (AP)

Quotable

"Prediction is hard, especially about the future."

Yogi Berra

FX Trading – Rant: So how about the mind of the market Mr. Expert?

The mind of the past is ungraspable;
the mind of the future is ungraspable;
the mind of the present is ungraspable.

- *Diamond Sutra*

As I said, I don't often watch TV. I know many do and seem to find it helpful. For me, it creates confusion. Watching the market each day is enough confusion for me. But unfortunately I did it again, flipped on the financial news yesterday afternoon, after leaving my screens, and there they were, the ubiquitous panel of "experts" to tell us exactly what happened yesterday, why it happened, and what to expect in the future. Ugghhhh……

There are continuous competing voices on TV—as planned. Most of the regulars on the financial shows are regulars because they are compelling speakers—confident, good-looking, and excellent with the appropriate sound bite that usually makes the host smile. Precisely because the shows are setup with competing voices, usually one of the talkers can later appear on the show and say, "See, I was right when I was on the show last time." It's an interesting game and at times very entertaining. But, I don't think it helps us make money.

Usually we can quickly and clearly grasp the mind of the guest on these shows. But grasping the mind of the market is where the real payoff is. And sadly, no matter how many times in a row you may get it right, and no matter how confident you are, there is no such thing as grasping the mind of the market.

The market is a chaotic non-linear system with organic human attributes.

It teases. It seduces. It coddles. It tricks. It traps. And every moment is truly unique. So one wonders how others can garner so much confidence in their own forecasts.

Do we forecast? You bet. Do we have confidence in our forecasts? Never! Confidence about a non-linear chaotic system can only come in degrees, and even those degrees of confidence are guesses.

Not all hope is lost. There are times when it seems our ability to predict is better than others. Thus we need to take advantage of it if we see it. Trading ranges, pivot points, support and resistance, and the like can help, and do help the trader. But when these change in a chaotic fashion, our predictability probability falls very fast.

But given that Mr. Market is a reflection of us and our methodology, it insidiously eats away at our so-called predictive systems. It's a continuously skewed Catch-22 so to speak.

I turn to Mr. George Soros on this key point…There are two functions operating in the market:

- Cognitive function
- Participating function

Here is the rub: "The two recursive functions do not produce an equilibrium but a never-ending process of change," writes Mr. Soros.

"The process is fundamentally different from the processes that are studied by natural science. There, one set of facts follows another without any interference from thoughts or perceptions (although quantum physics introduces uncertainty). **When a situation has thinking participants, the sequence of events does not lead directly from one set of facts to the next; rather, it connects facts to perceptions and perceptions to facts in a shoelace pattern.** Thus, the concept of reflexivity yields a 'shoelace" theory of history."

And put another way, by Mr. F.J. Chu, in his brilliant little book, "The Mind of the Market":

"Since the economy is extremely sensitive to changes in conditions, even a precise knowledge of a majority of the relevant dimensions of the economy will not necessarily lead to an accurate prediction. **This is the ultimate irony of chaos theory or any other similar predictive methodology. The more accepted and credible a predictive system is, the more it influences current decision-making and therefore modifies future expectations.** Stated alternatively, the wider the use of an indicator, the less useful ti becomes in beating the crowd."

Now, there a lot of people out there who already know all of this stuff, but I thought it might be worth a refresher if you have and be helpful if you have not. There are of course many who don't believe this stuff and do think they can forecast the market, usually they are the ones who show up on TV.

I once spoke with a very smart man. A man who has made hundreds of millions of dollars for himself and investors over the years—his name is Bill Dunn. I don't know Mr. Dunn personally, unfortunately, even though we live in the same town. But I do greatly respect him and what he has achieved. He is one of the largest Commodities Trading Advisors out there, and one of the most successful investors ever—real Hall of Fame material.

When I spoke to Mr. Dunn, about 15-years ago, we talked a bit about a man named Ludwig von Mises—a favorite of Mr. Dunn's and me. We discussed briefly the economy, etc. He was very gracious to even spend time with me—I was impressed. I asked him about how he thought x-y-z would impact the prices of x-y-z…I don't remember the exact question. But I do remember the answer, he said: "I don't know nor do I care. I'm interested in that stuff, but I never let it impact our trading decisions at Dunn Capital Management." That was a wake-up call to me at the time.

Here is arguably one of the best investors ever that doesn't try to forecast or predict, and by the way, you will likely never see him on TV. Years later read an interview of him in a book about trend trading, he hadn't changed a bit. He said this:

"I ride the bucking bronco."

Bingo! An ah-ha moment indeed!

Not sure there is a moral to this rant other than this: be careful about prediction and do it in time frame and during periods that appear seemingly better than normal for prediction, based on some knowledge of your edge (system for getting you in and out of trades). And of course, be careful of the most confident TV guests.

Mr. Mark Douglas of *Trading in the Zone* summed it up well:

"Every moment in the market is unique….and you don't need to know what is going to happen next to make money."

Take a position based on some probability that can be inched in your favor, put on a stop-loss to control risk; then ride the bucking bronco.

Right now, we are trying to ride the bucking buck higher…stay tuned.

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