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An Intuitive Economic Approach to Beating the Markets

The US and her allies were entering into Kuwait on 25 February 1991; with Lieutenant Commander Michael Riley monitoring the radar screens onboard the HMS Gloucester.¹

Everyone was on high alert working 6 hour rotational shifts as the allies were now launching an assault on the Iraqis. Riley had been on duty since midnight and at 5am he suddenly noticed something on his radar screens that made him extremely frightened.

He could see a green blinking dot moving at more than 500miles per hour towards a flotilla of ally war ships. The question running through his mind was whether this was a friendly US Air Force A-6 fighter plane or a more sinister Silkworm missile.

Usually one could tell the difference by the altitude; the missile travelled at a lower altitude but the altitude measuring device was incorrectly calibrated earlier in the evening and would take too long to fix in time to make a decision. Added to this the pilots had taken to turning off their communication out of fear of their signal being picked up by Iraqi intelligence, so Lieutenant Commander Michael Riley was faced with a tough decision.

With literally seconds before it would be too late, Riley issued the order to fire two Sea Dart surface to air missiles, in the space of a few short seconds an explosion erupted 700 metres from USS Missouri.

The question foremost on Riley's mind and his commanding officer was whether he had just killed soldiers on his side. After what seemed like an eternity it was confirmed that the moving dots on his radar were in fact enemy missiles and he had saved the day. An enquiry followed and nobody including himself could ever work out whether he was in fact just plain lucky, until a cognitive psychologist Gary Klein started investigating the case in 1993.

Having spent many decades studying high-pressure decision making, he knew the power of intuition. What he concluded after repeated analysis of the tapes of the radar screens was there was in fact a minute clue. Michael Riley had spent hundreds of hours watching the behaviour of dots moving on the radar screens he had also become familiar with certain patterns the A-6 fighter pilots had adopted when peeling off from their set flight paths, and in the early hours of that eventful morning of the 25th February his senses were alerted by the appearance of a blinking dot in slightly different spot that he had become accustomed to.

After spending every day of the last 8 years trying to work out what makes the stock market tick, I have come to the realization that having an intuitive approach to economics is probably your safest route to success.

I have come to believe that all the main economic schools of thought are right, but my qualification is that I think they are right part of the time or in certain circumstances, let me explain.

I believe the Austrian School provides economics with the clearest solutions for a moderate trade / business cycle thus avoiding major boom busts, but the model requires close to zero government interference, so this may be the best model but realistically it has the least chance of implementation in our current world.

I can respect the Keynesians belief that sometimes a jolt from the government coffers can provide sufficient stimulus to aggregate demand that it will revive an ailing economy. However, as a theory in totality it can be somewhat contradictory and I believe it depends on

¹ I came across this story in an amazing book called "The Decisive Moment" by Jonah Lehrer



the circumstances of the recession/depression and the state of the government's balance sheet.

I also understand how Milton Friedman's Monetarist School can provide stimulation to the economy by the amount of money of supplied, either indirectly through the discount rate or more directly by monetizing or sterilizing the countries debt.

There are other schools; however, for our purposes this is sufficient, so let's get to the point.

What I have come to learn from successful fund managers, Lieutenant Commander Michael Riley and people in general is that we have an ability to **intuitively** choose the best solution for the prevailing conundrum. We as a society fail to acknowledge the power in the intangible; we demand scientific certainty to the uncertain. This includes the quant managers who fool themselves into the comfort of the formulae without relying on their intuition regarding their assumptions.

The markets themselves are made up of a collective society of human beings interacting through a sophisticated barter system called the stock exchange. In the same way as we follow certain normative queues in our social interaction, we do the same in our stock market interaction. The process is always in motion and subject to individual whimsical action which shifts the onus onto the participants to make sense of what is going on.

It is very easy when approaching the uncertainties of the stock market to feel the need to contextualize the markets behaviour and apply some sort of reason to its actions. To this end many market participants myself included try at times to fit the current economic environment into an economic school of thought and we may find ourselves saying, yes the economy will now start growing because of governments increased fiscal spending, or we may say because interest rates are going down this will provide stimulation to the economy and so on, but the lesson I would like to suggest I have learned is that sticking to one school of thought and believing that it is the answer to all questions is the mistake, one needs to chop and change given the prevailing circumstances, and it is for this reason I recommend that you remain agnostic to economic schools of thought. That is not to say don't believe that there is an economic truth; it is more saying that each circumstance produces its own economic truth and you need to use your intuition to identify which economic truth fits the current situation.

I say this from a market practitioner's point of view; I am talking about someone who wants to make money in the market not somebody who is more interested in theoretical truths.

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