Bias #1: “Overconfidence” and “Pattern and Trend-Seeking Behavior” (part Recency Bias)

I feel it is important to preface this assignment with a little background. For most of my childhood and teenage life, I had very little knowledge of the financial world. I was generally interested in S.T.E.M fields and was heavily involved in things like robotics and coding. As high school graduation inched closer, I found myself more aware of the fact that while I enjoyed tackling various S.T.E.M problems and some of the more creative work that surrounded them, there was an interpersonal and developmental aspect I felt was missing. It just didn’t seem like the area where my interests, passion, or skills, would be best represented. I ended up deferring my acceptance to the University of California at San Diego (I applied as a nanotechnology major) to take a gap year and further explore my interests. It is here that my experience with overconfidence begins.

During the 2017-2018 academic year, I spent my time working at best Buy. I had a job while in high school, but this was the first time I was seeing any real money in my bank account. It was an odd feeling, but one that suggested I finally had resources to make use of. One day, an individual came into the store looking for a graphics card. We began talking and it turned out he actually wanted the graphics card so he could expand his cryptocurrency mining rig. This was not necessarily a new concept to me. The space has very close ties to the S.T.E.M fields and I had been exposed to the concept and workings of Bitcoin for some time. Regardless, this individual diverged into a conversation about “trading”. He told me that all his earnings from mining would go directly into a brokerage account where he would actively trade them. Again, trading and investing were not new concepts to me, but in high school, I always looked at them as rather mundane. Business classes were not something that ever interested me and so I never really got a good look at what investing or trading entailed. Hearing this customer talk about all the money he was making and showing actual trades on live accounts, sparked a desire for the same thing. Perhaps I could take some of the money I was making, trade it, and make more money. As a young person, I thought I had stumbled into this “secret” society of traders. I was determined from that moment on to learn all I could about trading, open an account, and never work a real job again.

In fairness, I accomplished one of those things. I spent the next two years neck-deep in trading and investing education. Everything I was looking for technical analysis related. Perhaps a new indicator, new support and resistance methodology, or even full “suites” of indicators that all provided various pieces of the puzzle. I dove into books, videos, courses (although thankfully I never spent any money), and even software to backtest various algorithmic methods (some were profitable, but I did not have the resources to make them cost-efficient or fast enough). In any case, the point here is that each time I found some new piece of information, I thought I had the secret formula

This bias is two-fold in the sense that I was simultaneously highly overconfident that I had cracked the code, but on top of that, I was applying pattern and trend-seeking behavior. This is the essence of technical analysis and I would posit that anyone who fails trading, continuously
relying on technical-analysis alone, is both overconfident in their ability to assess the market, and seeking out information from an inherently flawed system of information assessment.

I would be lying if I said this process was not still playing itself out in some way. Over the past 3 years or so, I have funded and completely blew up about three accounts, totally somewhere around $2,000. Thankfully, something clicked several months ago, and I finally learned the reality of my situation.

I have had periods of brief success, but these only deepened my desire to find some system that would provide consistent results. I always felt like there was just one piece of the puzzle I was missing. If I could find it, I would be successful. Ultimately, much of the loss I experienced was mental or made-up. I generally practiced on paper trading accounts, which saved me uncalculatable amounts of real money, but I also gave up precious time with family and friends. I was constantly searching for an unobtainable level of perfection and sacrificed countless hours of valuable time with the real-world for this fruitless pursuit.

It also seems worth mentioning that hidden underneath all of this is a very clear case of confirmation bias. By this, I mean specifically that every time I failed, I searched for some reasoning or validation. I wanted proof that my pursuits were just challenging, not altogether fruitless as the back of my mind kept telling me. I would be remiss not to accept that there are intuitional firms that make money from technical strategies. One example might be Renaissance Technologies, who are strictly looking for arbitrage-based and technically-sourced trading opportunities. In fact, their earliest systems are based on nothing more than mean-reversion in various commodity markets (Lewis, 2019). I recognize this is not information that proves it is possible to trade such strategies in modern retail markets, but it nonetheless provides a source of bias for those looking to provide themselves with motivation or “proof” that their pursuits are worth it. It is especially beneficial for avoiding the plethora of information that suggests trading is not, in actuality, a profitable pursuit.

**Bias #2: Disposition Effect**

This bias is more defined and translatable than the above. The basis of the disposition effect is cutting losses early and letting losers ride. The exact opposite of conventional financial investing practices. As I mentioned, there were periods where I stumbled upon a technique or set of indicators that provided inconsistent returns. During these periods I was able to dive into deep concepts of risk management (as it relates to trading, not investing). I began to employ my own “systems” that based individual trade sizing on the Kelly Criterion. The problem with this was that these systems require strict adherence to the math they are based on. If you have done your research and you are assuming a 5% return on a given trade, but in practice, you cut the trade at 3% to lock in profits or get into another trade, the model no longer works. You chip away at the very math the entire system is based on. This not only decreases your ‘risk: reward’ on a given trade but erodes any genuine mathematical edge over time.

The outcome of this is probably very apparent. I would get uncomfortable seeing unrealized profits. Rather than wait for a trade to get to the level I had calculated, I cut early to lock in the money. Similarly, I would let losses ride just beyond their intended stop-loss, or worse, average
into them at the lower prices (although many systems have an academically-sound format using this idea). Even if my trading had been a recipe for consistent returns (it wasn’t), my inability to stick to the system created impossible obstacles for the long-term.

While a “conclusion” was not required for the project, I do think it is worth noting that perhaps the largest outcome of this entire experience for me, was developing incredible patience and mental stability. I went through major ups and downs, both mentally and physically, throughout this time. At every peak and valley, I learned something new about myself. Perhaps most importantly, I figured out how to learn independently. I have gone on to actually educate myself on deeper economic principles, valuable modeling techniques, and other financial ideas that go beyond the scope of immediate college education. While these are not necessarily things that are required for a career or successful investing, they do unlock a different perspective in regards to the world of trading. While the path was nothing short of a nightmare, I am happy that I made it to the other side with clarity.