Grizzly bias

excerpt from Alpha Trader

Compulsive bearishness is a bias that has not received as much coverage as other forms of trader bias. The bearish bias in the market since 2008 is probably the costliest human bias in finance. Think of all the money lost on short ES futures in the past 10 years. All the "crash is imminent" blog posts. All the apocalyptic hedge fund bets. Crazy.

One way that permabears justify imminently lower equity prices is by referencing the bond market. If yields are going up, that's bad for earnings, bad for margins, bad for borrowers, bad for severely indebted sovereigns, etc. If yields go down, it's "What do bonds know!?" or "The rates market don't lie!"

The relationship between stocks and bonds is fluid and for most of my lifetime, stocks have been going up and bonds have been going up. This is not to say it will go on forever, only to say that stock market bears need better reasons than "yields are going up" or "yields are going down". In times of plentiful liquidity, it is perfectly logical for both stocks and bonds to go up, up and away.

Bears sound smarter than bulls

Research shows conclusively that humans perceive people who present negative or pessimistic opinions as more intelligent than those who express positive or optimistic opinions. Bearish analysts are viewed as "cutting through the noise" while bulls are often viewed as naïve fanboys banging pompoms together on CNBC.

Strangely though, the path of human progress is an undeniable upward trend. As Deirdre McCloskey put it:

… pessimism sells. For reasons I have never understood, people like to hear that the world is going to hell, and become huffy and scornful when some idiotic optimist intrudes on their pleasure. Yet pessimism has consistently been a poor guide to the modern economic world[1].

Similarly, stocks mostly go up, most of the time. Morgan Housel put it like this[2]:

In investing, a bull sounds like a reckless cheerleader, while a bear sounds like a sharp mind who has dug past the headlines – despite the record of the S&P 500 rising 18,000-fold over the last century.

Yet many of the best-known Wall Street pundits are persistently pessimistic and many of them have been around for decades. Think of all the famous bears in finance. I could make a list 20 names long without even Googling. Plenty of them have cool nicknames and there are even two different celebrity economists nicknamed Dr. Doom. I find that funny.

[1] http://www.deirdremccloskey.org/docs/pdf/PikettyReviewEssay.pdf
[2] https://www.fool.com/investing/general/2016/01/21/why-does-pessimism-sound-so-smart.aspx I learned of the mcloskey quote (footnote 1) from this article, too.

These are all incredibly smart guys who do amazing analysis that mostly points to an imminent large-scale bear market. And yet the evidence shows these forecasts are almost always wrong. Why do we keep reading their stuff? Because it sounds really smart! The forecasting business has very little accountability and is mostly about marketing and sounding smart, not accuracy.

These permabears are famous and they are highly paid. How is this possible when stocks have spent most of their time in a bull market since 1980? If you always call for a bear market, and then one happens, were you right? Answer: it doesn't matter. Pessimism sells, even if it's the wrong view most of the time. When you read a "*crash is imminent!*" piece ask yourself: is the author preying on my inherent negativity or is she actually providing useful and actionable analysis supported by a verifiable track record?

There is an entire industry of permabears because there is steady demand for them. Don't stoke that demand. Permabears sound smart, they are entertaining and they reassure us that our intelligent skepticism is not misguided despite mountains of evidence to the contrary. The funny thing is, if these permabears ever change their view, they lose followers and subscribers.

There is a tried and true strategy in the financial media: adopt one dramatic world view, stick to it no matter what happens, and sell sell SELL *SELL* it no matter what new information comes in to contradict your viewpoint. As the saying goes: never let the facts get in the way of a good story.

To be clear, I'm not advocating a permabull stance either. That would be equally bad. As a trader, you need to be flexible and open-minded, not perma-*anything*. This discussion is meant to make you think about how pessimism is like intellectual candy. It tastes delicious, but it's generally bad for your financial health.

Negativity outsells positivity everywhere you look. Cynics and critics sound smart. People love to read negative stories. Here's a short excerpt from a study of how people perceive writers of book reviews[3]:

Negative reviewers were perceived as more intelligent, competent, and expert than positive reviewers, even when the content of the positive review was independently judged as being of higher quality and greater forcefulness.

The same bias exists in non-financial news. Multiple experiments show that people claim to prefer positive news but actually prefer to consume negative news. This negativity bias is part of human nature. Even infants react to negative stimuli with more intensity than they do to positive stimuli. When people of any age are subjected to two stimuli of equal intensity, one positive and one negative, the negative stimulus has a greater psychological impact than the positive one. Negative impressions are more salient and more memorable.

Negativity is an attention magnet. Like McCloskey said: "Pessimism sells." Be a rational consumer of information and do not allow smart-sounding permabears to bias your process.

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[3] Teresa Amabile, "Brilliant but Cruel: Perceptions of negative evaluators" (1983).

Ignore the permabears.

Stories of funds that set money on fire trying to short stocks are plentiful. One fund I know opened in 2012 and the first trade they did was go short S&P futures. The last trade they did before shutting down in 2016 (due to poor performance) was cover a short S&P futures position. Another fund made 22% on Abenomics in 2013 but lost 18% on bearish S&P bets that year and ended around flat overall. It is a costly bias. When you trade, you should always be equally able to go long or short risky assets. If you can't, it's a major leak you need to work on.

Warren Buffett said it best:

"For 240 years it's been a terrible mistake to bet against America, and now is no time to start. America's golden goose of commerce and innovation will continue to lay more and larger eggs."

- Warren Buffet's 2015 Investor Letter