

Predicting People and the Stock Market

Auction markets reach decisions between people. Personal choices are made between a person and their environment. This can also be seen as an auction market.

“In the stock market, the most important organ is the stomach. It's not the brain.”

— [Peter Lynch](#)

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What an Auction Market Is

The stock market represents collective thinking with broader reach and more effective participation than politics. Its materialistic focus makes it feel less relevant, but the greater commitment and consequences for those who take part make it an impactful tool for organized behavior.

I’ve traded stocks, commodities, currencies, funds, and options for 40 years. I’ve studied accounting, macro- and microeconomics, and analyzed stock movements in detail. I even applied for a job as a stock analyst, which I’m lucky I didn’t get. It’s a field that’s simultaneously frustrating, interesting, boring, and elusive. You often feel you’re gaining insight only to have it blow away.

What makes the trading field boring is the people, as there really aren't any. Everything is hidden behind the data. The only people you're likely to encounter are brokers who have neither skin in the game, nor opinions worth listening to.

The data is boring if you only see noise, but there are signals of significance. Unfortunately, they're historical correlations with little power of prediction. We know many things that move markets, too many in fact, but everyone's predictions are already folded into the prices that we see.

What makes it interesting is the flow of information, both where it comes from and how fast it travels. On one hand, it feels like everything is noise. On the other hand, anything can be significant. The only way to test any idea is through prediction and back-testing. That is, taking ideas that seemed to explain one situation and applying them to others. This is where insight usually fails. It's also where analysts, the public, the market, and most experts also fail.

The reasons markets are unpredictable make the problem interesting. One reason is that markets are predictive by nature. Markets assign things a future value, not a present value. As a result, even a perfect analysis of the present is irrelevant. Everyone bases their actions on various uncertain predictions for the future.

The question becomes what possibilities are people weighing, what expectations do they have, how certain are they of each, and over what time frames do they expect these outcomes to manifest? The amount you're willing to invest in a house today will be different if you feel you'll need to sell it in one year versus selling it in 30 years.

While all markets advertise a current price for items, they also have unadvertised prices for the same products held for different lengths of time. Each duration of investment essentially defines different products. Different future expectations of risk and return, and other impactful variables, are wrapped into the current price but cannot be extracted from it.

Is This Real Democracy?

"In the short run, the market is a voting machine. In the long run, it is a weighing machine."

— **Benjamin Graham**

Public auction markets are more democratic than anything else we're involved with, as everyone's money is the same. You may be negotiating with a pauper or a prince, and you'd never know, and it wouldn't matter. There is something appealing in this, as it's only the data that matters.

A second reason auction markets are interesting and unpredictable is that there is no single measure of future value. There are many measures and each depends on the situations of those taking part. For example, investing small amounts of expendable money has little consequence, so people accept higher risks, while investing large amounts of borrowed money causes people to be risk averse. The same people may bargain for the same products, but weigh information entirely differently.

The third reason markets are unpredictable is human nature. We derisively refer to fear and greed as prime motivating forces, unless they're our own, in which case they make perfect and reasonable sense.

Rather than deprecating people's emotions, the better insight is to recognize that people evaluate opportunity and risk in warm and fuzzy ways. This makes markets psychologically interesting. It's also what makes markets a unique laboratory for understanding how people think.

Trading is not gambling unless risk is disregarded altogether. As long as future projections have some basis in fact and expectations can be tested, trading is a game of skill and not a game of chance. This is an interesting spectrum, and the underlying question is whether the odds are fair or skewed.



Market analysis is presented and sold as valuable for making predictions, but most of it is not useful. This highlights the key difference between untestable historical correlations and testable future predictions. In my experience, most people taking part in large, public markets do not know the difference but, in their defense, it's hard to know.

Why You Should be Interested in Auction Markets

You can consider every decision you make to be similar to assigning a price in an auction market. Every consequential decision you make, whether it's material, personal, or spiritual, weighs your options. Even animals whose intelligence we cannot fathom make decisions and are effectively participants in an auction market. Whether or not a bird comes to the feeder, when to cease a contest

over territory, or how to respond to a noise in the environment. These are not negotiations between parties, but they still require different values for different actions.

A fascinating theory in the operation of markets is that future values can be predicted by examining nothing more than patterns in the past. In financial markets, this is called technical analysis. It enlists such predictions as, “if a price has made an unusually large move in one direction, then the longer it persists in this move, the less likely it will continue to move in this direction in the future.”

This is based on the idea that it’s most likely noise that pushes situations away from their stable average and that, over time, they will return to their average. It’s a plausible idea when changes appear for no discernible reason, but it’s not plausible when the evidence supports a significant change.

This may seem reasonable to you, but it is false for systems that move at random. For those systems, by definition, the past tells you nothing about the future. But we know that this is not true, and that the past does tell us something about the future. Therefore, we do not expect these systems to behave randomly.

We find ourselves in this position on many situations in our personal lives. As a counselor, I spend much time with clients exploring what changes have occurred, what changes might be occurring, and what changes they may make themselves. The idea that a person’s problems will “regress to the mean” is implicit in all actions, and the usual purpose of counseling is to explore ways of developing a new average.

Financial markets assign prices. People think the price is somewhat fair, even though price is an evanescent quantity that only summarizes the expectations of those people who are currently negotiating.

While every price is literally an agreement between only two parties, there is often an army of thousands of others standing on either side of these two participants. What is important, then, is not what price was agreed upon, but how many people will support that price in the future. Price is simply a compromise between two people, but value is determined by the whole population.

For example, the cost of bus fare out of the city is based on the cost of the service and the quantity of demand. A natural disaster in the city could cause a huge rise in demand and completely upset the price of bus tickets tomorrow. In another case, the last sale could represent the last person willing to pay the advertised price so that there will be no further sales.

Realistically, the bus company would not respond quickly, and ticket purchases would either cease for lack of demand, or bus services would be crippled by a lack of supply. In those cases, other vendors would appear to soak up the demand at higher prices or create demand at lower prices.

Collective Thought

These markets are a fundamental aspect of life, yet we see them as games. In fact, the revolution in board and computer games is predicated on gamification of this sort. This is supported by an increasingly algorithmic social mindset. This attitude has been fostered by the expanding

computerization of our world. With the burgeoning use of artificial intelligences, this trend in thinking will increase.

Anyone seriously interested in improving their performance at virtually anything “gamifies” their efforts, but most of us don’t recognize we’re doing this. Practice is a useful game when there is a choice of actions, a consequence for decisions, and a scarcity of resources. Take away any of those three and there is no value to the game beyond wasting time.

Collective thought shares many structures similar to individual thought, influenced more strongly by common feelings and less by insight. Watching the actions of groups makes clear how little of it is guided by thought. Most group actions are guided by prejudice and preconception.

It’s often said that our actions are directed by social and institutional media, but anyone who reviews either will find little content. There is little new in the news, and nothing new in social media, so what is shaping our collective thoughts?

Our thoughts are formed before we’re informed. Almost all our thoughts are preconceived, the rare exception being unexpected emergencies. The sharing of thoughts through print and electronic media does not act to change us but to collect us, separating us into common-thinking groups. We see this on three levels: personal communication, daily news, and literary arts.

Most personal communications explicitly act to build consensus; allies work to strengthen their bonds. If you look at news headlines across the world, you’ll find little difference between them, or substance in the stories behind them. The topics and themes that are reported are those which already resonate with the readership.

Books, video, and performance are even more carefully curated to exploit or direct public opinion. The security of corporate investments rests squarely on mediocrity, and any deviation is scrutinized for profitability. The reason the best creative work seems to come from nowhere is because it does: there is no venue to support novelty.

Technology is making innovation cheaper and production easier. Anyone can write, polish, format, and publish a book with worldwide distribution for no more cost than the time to create it. It requires inexpensive software and costs nothing to upload the print-ready product to Amazon.

This means of distributing insight could have a greater effect on society than the combined effects of politics, government, and private enterprise. It’s not the technology that’s doing it, the technology is only facilitating it. It’s driven by individuals.

My Predictions

I see three predominating trends:

- 1 - The auction model of setting values will become more prevalent in society as information becomes more available and consensus more easily determined. We will see auction-based determinations of human values.

2 - Artificial intelligence, which is actually a suite of automating technologies, is driving most people to act collectively while stimulating some people to act differently. While the consensus will grow, the power of divergent thinking will also grow. On balance, the power of the majority will weaken.

This reflects fear's greater role in establishing consensus, and the lesser recognition of opportunities to diverge from it. Just as in auction markets, the divergent thinkers will experience greater profits and losses. The mavericks will guide the future, not the average consensus.

3 - Individual creativity will become more important as information becomes more homogenized and consensus narrows. Algorithmic tools will become more useful in establishing consensus but also in diverging from it.

In the past, the gun lobby defended their right to bear arms with the slogan, "guns don't kill people, people do." This exonerated the machine. In the future, this will no longer be the case. The human role will become more difficult to discern, but also more important.