Contrary Thinking

This article is about one art that distinguishes successful investors from those who are less successful. This art is called contrary thinking. For most investors, it is something that is not easy to develop, but if the effort is made it can be very rewarding.

Contrary thinking is a habit of questioning everything – asking whether there is a point of view that is contrary to what the market crowd is currently believing. It sounds as though it might not be that difficult, but it requires consciously working at it to change one's natural habits of thinking.

The reason that contrary thinking is a difficult habit to cultivate lies in the way we naturally think and feel. Most of us are uncomfortable if we find ourselves alone physically or mentally. Most of us find isolation very difficult to endure, which is why it has been used through the ages as a severe form of punishment. However, isolation does not have to be physical. We are equally uncomfortable in a group of friends if we are the only one holding a view about something. We tend to either keep quiet, or more likely we go along with the crowd, saying nothing, but feeling a little less than secure.

This is because each of us to a large extent defines who we are in terms of groups. When we are puzzling over something we might do, or invest in, we consult the group to find comfort when we get peer reassurance that we are on the right track. That, or if the group disagrees with us, we have a strong urge to lose faith in our chosen course of action and possibly to abandon it.

This process reinforces our need to conform, in case we lose our sense of identity with the group. It feels better to be wrong in company than to take an independent stance, even if it turns out to have been the right thing to do. It is so much more comfortable to be a part of the crowd. We feel that even if we turn out to be wrong, nobody can blame us. We feel safer in the pack.

The point about contrary thinking is that this will not work very well at all in investing. The problem is that at the important turning points in the market, the crowd all thinks the same way and they will all be dead wrong. It follows that, to beat the market crowd, we must do something different to everyone else at turning points. Note that the crowd is mostly right most of the time. It is at turning points they are wrong. That is when it is important to utilise contrary thinking.

So, the first step is that group opinions are positively dangerous at turning points in the market. However, it is difficult to be objective in the face of the crowd as fear, greed, hope, ego and wishful thinking are all urging us to not be independently objective about the situation. Overlaid on the situation is that we have been correct along with the crowd up to this point. We will have expressed our opinions then and now it becomes very difficult for us to overcome the strong urge to just continue defending our opinions, blocking out the disconfirming evidence that is emerging around us.

These are the three key principles of contrary thinking:

1. Never trust in widely held beliefs. The more widely held a view and the more strongly it is held around us the more alert we should be to questioning it. We must force ourselves to ask and think through whether there are any other possible views and what evidence exists

to support them. Once we start to do this it is truly amazing how our whole perspective can change. If we cannot come up with another view, the best course is to seek out someone who might be able to help us see other sides of the question. It will not be easy and will often mean going outside the normal groups we belong to.

2. We must quietly, but persistently question our own beliefs. The composer Richard Wagner was one who held contrary views about his art. He believed that each year we should question our existing beliefs. This is what we should be doing with our investing, and especially so when we feel nice and comfortable about how things have been going. The investment sky may seem clear and we are basking in how well things are running along. This is a very dangerous state to be in. It should be a trigger to start asking what might be wrong about the situation. What storm clouds might be on the horizon, but we have not taken note of them? Even when everything still seems alright on reflection, it is very powerful to try to imagine and note down things that might remotely go wrong and how we would spot them early if they emerge. This kind of contrary thinking expands the mind in a very powerful way and is well worth practising.

3. Whenever we are making an investment decision, ask why we might be wrong. After all, if we are going to buy a stock and are so sure we are right, ask why would someone sell to us on the other side of the trade. Investing decisions are never totally clear-cut, one-way streets. There are always pros and cons of any situation. If we can only see the pros in a situation, we are only seeing half of the picture. Before acting, stop and list the contrary points of view about it. If we cannot come up with them, seek out someone who can help with other views. Remember, that the comfortable thing is the exact opposite – to seek a like-minded person to assure us we are right. Believe me the most valuable people we work with in investing are people who disagree with us. They test us in powerful ways. We should seek them out and listen carefully to them no matter how uncomfortable it is at first.

So, contrary thinking is a process of forcing ourselves to examine all the facts and weigh up all the evidence. Until we have done this, we may not have made a sound decision and, at important turning points in the market, we will most likely make a wrong decision, or fail to act when we should.

Then it takes courage. We must be prepared to trust our analysis based on contrary thinking and be prepared to quietly, but firmly act contrary to the crowd when called for by our thinking through and weighing up all sides of the question.

That, then is the challenge. It is well worth the effort, but allow me to warn you that:

1. It will be very difficult, especially at first. Contrary thinking calls on us to question everything.

2. For most people it will be a new and very challenging experience, both intellectually and emotionally. Do not underrate how difficult it will be until the new skill is firmly established.

3. Contrary thinking calls on us to change the habits of a lifetime by unlearning the natural urge to not think for ourselves, but to simply follow others.

4. Finally, contrary thinking does not involve having a high IQ. Instead it is a developed habit. The way to develop a habit is to start consciously changing the habit until it becomes a new way of thinking. So, at first it must be a very conscious effort. However, with persistence and avoiding back-sliding the new habit of contrary thinking will become one of the most powerful tools in our investment armoury.

For a fuller discussion of crowd behaviour and contrary thinking see Part Three of my book *Think like the Great Investors.*

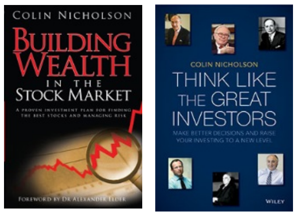
To read more of my work

Previous Articles

All my previous articles for the free website are now on the *Educational Articles* page on the Free Resources menu. They are now listed alphabetically by title with a brief description of their contents.

Books

I have written two books, both of which are available for purchase from the ***Buy Books*** menu:



BUILDING WEALTH IN THE STOCK MARKET – A proven investment plan for finding the best stocks and managing risk

THINK LIKE THE GREAT INVESTORS – Make better decisions and raise your investing to a new level

Members Website

Follow my thinking on my own investments, disclosure of my portfolio as I go, weekly market scans, weekly market charts and analysis plus many more articles about investing and analysis

I am one of the very few investors who publishes their investment results each year, which I have done since 2000 – see the Investment Returns page on the About Colin menu on the website