THE STABILITY PARADOX: A STUDY OF COGNITIVE DISSONANCE IN HIGH-LEVERAGE RETAIL RISK PREFERENCES

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Abstract: This study aims to explore a widespread phenomenon among high-leverage retail investors in China's futures market that can be termed a "stability paradox." That is, investors express an extremely strong desire at the subjective level for "long-term stable profits" or even "financial freedom," yet in actual trading they display highly risk-seeking behavior, such as taking oversized positions, stubbornly holding against the trend, and trading frequently. This behavioral pattern is characterized, in terms of mathematical expectation, by high variance and negative returns . Based on Huishang Futures Co., Ltd.'s 2019 client survey data (valid samples N = 773) and the "2021 National Futures Market Trader Status Survey Report" released by the China Futures Association (N = 6034), this paper adopts a mixed-methods approach that combines quantitative statistics and qualitative textual analysis to examine in depth the psychological mechanisms behind this "knowing–doing gap."

The study finds that 95.34% of respondents cognitively acknowledge that futures investing requires professional learning and strict rules. However, at the execution level, 46.05% of traders admit to "having a plan but being unable to execute it," and 35.06% explicitly state that they "cannot stop loss in time." Qualitative data further reveal that investors resort to "external attribution" (such as complaining about manipulation by large players or excessively high commissions) to alleviate the cognitive dissonance arising from violating their own trading discipline. This paper argues that high leverage not only amplifies asset price volatility but also greatly magnifies investors' mental-accounting biases, causing them to fall into a vicious cycle of "pursuing (imagined) quick stability by adopting (in reality) extremely unstable strategies."

Keywords: stability paradox; cognitive dissonance; high leverage; disposition effect; attribution bias; retail trading behavior.

1. INTRODUCTION

1.1 Research Background: Asymmetric Temptation and the Retail Ecology

As the core venue for risk management and price discovery, the derivatives market serves as a curve-smoothing tool for institutional investors, but for the vast retail community it more closely resembles a game arena of "asymmetric opportunities." The futures market's unique margin system (T+0, two-way trading, high leverage) offers individual investors a theoretical possibility of "wealth compression" — that is, magnifying returns through leverage to achieve rapid class mobility in a very short time. However, behind this allure lies the harsh reality of a zero-sum (or even negative-sum) game.

China's futures market is characterized by a distinct "retail-dominated" structure (Barber et al., 2009; Glaser & Weber, 2007; Coval & Shumway, 2005; Feng & Seasholes, 2005; Chen et al., 2007). According to the 2021 survey report of the China Futures Association (China Futures Association, 2022), male traders account for as much as 76.4% of individual participants, and those aged 26–45 comprise nearly 70% (67.9%). In the behavioral finance literature, this demographic feature — young and male — is typically associated with significant overconfidence and high risk preferences (Barber & Odean, 2001). In this highly volatile and high-pressure environment, investors' psychological biases are magnified by leverage, making the futures market a natural laboratory for studying cognitive dissonance.

1.2 Proposal of the "Stability Paradox"

In traditional finance, the CAPM model assumes that investors are risk-averse — they are only willing to bear higher risk when pursuing higher returns. However, analysis of Huishang Futures' micro-level data reveals a significant behavioral anomaly (Huishang Futures, 2019a), which we define as the "stability paradox."

Its specific manifestations are as follows:

Conservatism at the goal level: When asked about their "futures investment ideal," the vast majority of retail investors use expressions such as "stable profits," "supporting the family," "capital preservation,"

and "financial freedom." This demonstrates their longing for a low-variance, linearly growing equity curve.

Aggressiveness at the means level: In actual trading, the same group of investors exhibits extreme risk-seeking behaviors such as "liking to go all-in" (29.24%), "not setting stop-losses" (35.06% unable to execute stop-losses), and "stubbornly holding against the trend."

This logical contradiction of "attempting to achieve stability via creating extreme instability" forms the core of this study (Fama, 1970; Grossman & Stiglitz, 1980; Kyle, 1985; Lo, 2004). How do investors psychologically reconcile this vast cognitive gap? Not only do they fail to correct their behavior after repeated losses, they often increase their risk appetite when in a loss state (the Break-even Effect), which runs counter to their original intention of "seeking stability."

1.3 Research Objectives
This study aims to:

Quantitatively analyze the "knowing–doing gap" between retail investors' formulation and execution of trading plans (Jegadeesh & Titman, 1993).

Use Prospect Theory to analyze the mental-accounting mechanisms behind "not cutting losses."

Explore how attribution bias under high leverage hinders investors' learning curves (Shiller, 1981).

Combine macro-level (association survey) and micro-level (futures company data) perspectives to propose targeted investor-education strategies.

2. MATERIALS AND METHODS

2.1 General data
The data used in this study mainly consist of two parts:

Proprietary micro data: We employ a proprietary dataset (N = 773) containing investors' subjective mental-account descriptions (Huishang Futures, 2019a). In addition to the statistical results of closed-ended questions, the dataset contains highly valuable open-ended responses (e.g., "common reasons for losses," "investment ideals"), which provide rich material for qualitative analysis. In addition, satisfaction survey data for the first half of 2022 are used as a supplement on the dimension of perceived service.

Macro data: The "National Futures Market Trader Status Survey Report (2021)" released by the China Futures Association, with a sample size of 6034 (China Futures Association, 2022), is used as a benchmark reference for the overall market.

2.2 Data Description and Sample Characteristics
(1) Demographic Characteristics and Investor Profile

The sample in this study presents typical characteristics of the Chinese futures market: predominantly middle-aged and young males, a group that is usually highly correlated with psychological traits such as overconfidence (Barber & Odean, 2001). According to the "National Futures Market Trader Status Survey Report (2021)," Chinese retail futures traders tend to have high educational attainment and medium income levels:

Education: 79.4% have received higher education, of whom 69.9% hold a bachelor's or associate degree, and 8.8% hold a master's degree.

Income: 60.3% of traders have an annual after-tax income between 100,000 and 500,000 RMB.

Insight: This is not a group of cognitively deficient "gamblers," but rather a cohort of well-educated core social forces who may be quite accomplished in their own professional fields. This "competence transfer bias" may lead them to mistakenly believe that their successful experiences in engineering or management (such as planning and control) can be directly transferred to the chaotic futures market, thereby underestimating the market's complexity.

(2) "Formal Rationality" in Asset Allocation
From an asset-allocation perspective, retail investors exhibit a kind of formal prudence:

Data show (Huishang Futures, 2019a) that 86.4% of individual traders keep futures funds within 30% of their household financial assets, and 46.3% keep them within 10%.

In terms of product choice (Huishang Futures, 2019a), agricultural products (73.3%) and energy-chemical commodity futures (67.7%) with good liquidity are most popular, while participation in financial futures is relatively low.

Insight: This "small-stakes for fun" asset structure in fact provides a psychological safety cushion for their extreme risk-taking behavior within a single account (De Bondt & Thaler, 1985). Thaler's (1999) mental-accounting theory is validated here: investors treat futures accounts as independent "gambling accounts," segregated from "safe accounts" such as bank deposits (held by 59.8%). While this segregation protects the household's asset floor, it removes the risk brakes within the futures account, exacerbating aggressive speculative behavior inside the account.

2.3 Literature Review and Theoretical Framework
(1) Cognitive Dissonance Theory and Investment Decisions

Festinger's (1957) theory of cognitive dissonance posits that when an individual holds two or more inconsistent cognitions (beliefs, attitudes, or behaviors), psychological discomfort arises, which in turn drives the individual to change cognition or behavior to restore balance (Tversky & Kahneman, 1974). In financial markets, when the self-concept of "I am a rational investor" clashes with the reality of "I blew up my account again," investors often do not admit their mistakes (change behavior), but instead alter their cognitions through rationalization(Statman, 2011; Kahneman, 2011).

Goetzmann and Peles (1997) show that mutual fund investors reduce cognitive dissonance by exaggerating past returns. This study explores how, in the futures market, investors use "external attribution" (such as blaming sudden market moves or software failures) to alleviate the sense of dissonance caused by violating their own trading plans.

(2) Prospect Theory and the Disposition Effect

Kahneman and Tversky's (1979) Prospect Theory indicates that decision makers are risk-averse in the gain domain and risk-seeking in the loss domain (Shefrin & Statman, 1985; Dhar & Zhu, 2006; Genesove & Mayer, 2001; Benartzi & Thaler, 1995). This asymmetry leads to the "disposition effect," whereby investors tend to sell winning positions too early (locking in gains) and hold losing positions too long (hoping to break even) (Shefrin & Statman, 1985).

In the high-leverage environment of the futures market, the consequences of the disposition effect are devastating. Being "trapped" in stock markets may primarily imply a loss of time, whereas "stubbornly holding" in futures markets often directly results in forced liquidation. The data in this study will test how this theory manifests in this specific market environment.

(3) Overconfidence and the Illusion of Control

Barber and Odean (2001) point out that male investors tend to exhibit higher levels of overconfidence, leading to overtrading and harming net returns (Weber & Camerer, 1998). Langer's (1975) concept of the "illusion of control" explains why investors believe they can predict inherently unpredictable markets. By combining survey data on "all-in trading," this study analyzes how overconfidence acts as a catalyst for the "stability paradox" — investors mistakenly regard high leverage as a shortcut to financial freedom rather than an accelerator of ruin.

In order to construct the psychological map of the loss patterns of retail investors: We conducted a cluster analysis on thousands of text responses from (Huishang Futures, 2019a) data.

3 RESULTS

3.1. The Knowing–Doing Gap: The Formulation and Collapse of Trading Plans
(1) "Plan–Execution" Matrix Analysis

Trading plans are at the heart of professional trading. Huishang Futures' survey data reveal a shocking "separation of knowing and doing" (Huishang Futures, 2019a). Regarding the question "Do you formulate a trading plan before trading? Can you strictly execute it when trading?", although most investors formulate strategies, a substantial portion are hindered by execution barriers. The figure of 46.05% is the most direct evidence of the "stability paradox." Nearly half of these investors are not ignorant of technical analysis (indeed, 90.7% wish to learn technical analysis), nor are they unaware of rules; rather, they are trapped in the physiological mechanism whereby the emotional brain (amygdala) hijacks the rational brain (prefrontal cortex). When market volatility touches psychological thresholds, plans are thrown aside and replaced by dopamine-driven impulsive trading.

(2) Misaligned Educational Demand
While admitting their "lack of execution," investors' demands for external support point in the wrong direction:

On the demand side: Data show that 90.69% of investors wish to learn "technical analysis methods," and 79.69% hope to learn "fundamental analysis."

The contradiction: Their main problem lies in "being unable to do" (execution/psychology), yet they attempt to solve it by learning more about "how to do" (techniques/analysis). This is a typical attribution error — believing that losses occur because "the analysis is not accurate enough," rather than because they "cannot control their hands."

This misalignment creates a vicious cycle: learning more technical indicators → trading systems become more complex → decisions become more hesitant → execution worsens → losses occur → they believe their technical skills are still insufficient → they continue learning new techniques.

3.2. Psychological Barriers to Stop-Loss: Empirical Evidence of Loss Aversion
(1) The Statistical Reality of Stop-Loss Execution

Stop-losses are the lifeline of futures trading. However, data (Huishang Futures, 2019a) show that when asked, "When your trade is in a loss, can you stop loss in time?":

No: 271 people (35.06%).

Yes: 502 people (64.94%).

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Although on the surface 65% claim they can stop loss, qualitative data analysis (Huishang Futures, 2019b) reveals a much grimmer reality. In response to the open-ended question "Please list your common reasons for losses," "failure to stop loss (stop-loss too large, frequent stop-loss)" ranks first by an overwhelming margin, being mentioned by 326 people, accounting for as high as 42.7%. This means that even those who selected "yes" in the multiple-choice question admit in retrospective reflection that stop-loss failure is the main cause of their losses. This reflects self-report bias — people tend to beautify their own behavior.

(2) Text Mining of Loss Causes

Clustering analysis of thousands of textual responses in Huishang Futures (2019a) allows us to construct a psychological map of retail investors' loss patterns:

(a) "Stubborn Holding" (The Dead Carry)

Typical expressions: "Hanging onto the position," "stubbornly holding," "reluctant to stop loss," "having a lucky mindset," "always thinking there will be a pullback."

Theoretical explanation: This is textbook behavior of "risk-seeking in the loss domain" under Prospect Theory. Realized losses bring immediate psychological pain, whereas floating losses preserve hope of "breaking even." Under high leverage, such delay rapidly transforms a manageable loss into a full-blown account blow-up. Data show (Huishang Futures, 2019a) that 73.7% of investors can tolerate losses up to 30%, yet under all-in trading, a mere 3–5% adverse move in the underlying is enough to break this psychological bottom line, causing investors to enter a freeze response and consequently be forced into "stubborn holding."

(b) "Oscillation of Greed and Fear" (Greed/Fear Oscillator)

Typical expressions: "Unable to hold winning trades — they turn into losses when held," "taking profits too quickly and stubbornly holding losses," "greedy — failing to exit when I should."

Theoretical explanation: This is the other side of the disposition effect — risk aversion in the gain domain. Retail investors seek certain psychological rewards through "taking profits early," thereby not only cutting off profits prematurely but also sharply lowering the reward–risk ratio. This pattern of "cutting profits short while letting losses run" mathematically guarantees a negative long-term expected value.

(c) "Itchy Hands"

Typical expressions: "Frequent trading," "cannot control my hands," "feel like trading whenever I see the market," "placing orders impulsively."

Theoretical explanation: This reflects a dopamine addiction mechanism. For some retail investors, futures trading offers not just monetary returns but also emotional value (excitement). Trading for the sake of trading (sensation seeking) directly leads to soaring transaction costs and a declining win rate.

3.3. The Leverage Trap: All-In Trading and the Illusion of Control

(1) The Data Paradox of All-In Preference

Question 4 in the Huishang Futures (2019a) questionnaire — "Do you like all-in trading?" — reveals an astonishing proportion:

Yes: 226 people, accounting for 29.24%.

No: 547 people, accounting for 70.76%.

Nearly 30% of investors favor all-in trading. In the futures market (typically 10x leverage), going all-in means that account volatility is 10 times that of the underlying asset.

Paradox analysis: Combined with national survey data (China Futures Association, 2022), 73.7% of investors can tolerate a maximum loss of no more than 30%. However, under an all-in strategy, a mere 3% adverse move in the underlying asset will shrink account equity by 30%.

Conclusion: For these 29.24% of all-in enthusiasts, their position-management strategy (all-in) and their loss tolerance (< 30%) are mathematically mutually exclusive. This structural incompatibility ensures that even mild market disturbances will drive them into panic, triggering irrational stop-losses or account blow-ups.

(2) Cognitive Split Between "Quick Money" and "Stable Profits"

In statistics on "investment ideals" (Huishang Futures, 2019a), although 39.3% admit that they are trading "simply to make money/get rich," 26.2% still pursue "stable profits" and 19.6% pursue "financial freedom."

Those who both pursue "stability" and enjoy "all-in trading" fall into severe cognitive split. They attempt to use the riskiest tool (all-in futures) to achieve the most conservative goal (stable income like a salary). This divergence between means and ends is the most extreme manifestation of the "stability paradox." They often reconcile this contradiction via overconfidence — firmly believing that their judgments are absolutely correct, so going all-in is not a risk but an efficiency gain.

3.4. Attribution Bias: Externalizing Responsibility

(1) Scapegoat Mechanisms

When trades fail, retail investors tend to use external attribution to protect their ego. Textual responses in the Huishang Futures (2019a) dataset are filled with such statements:

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"Big players are targeting my orders": A typical persecution delusion. In reality, most retail positions are too small to be noticed by large players. This belief prevents investors from reflecting on their own skills, leading them instead to view the market as unfair.

"Commissions are too high": Many investors demand lower commissions. While low costs matter, for those who lose tens of thousands in a single trade due to "not cutting losses," a few dozen yuan in commission is certainly not the core issue. Focusing on secondary contradictions (fees) while ignoring primary contradictions (risk control) is a psychological defense mechanism.

"Software lagging/insufficient functionality": Although data show that satisfaction with software speed is as high as 8.86/10, some losing traders still blame their losses on tools.

(2) Dependence on "Signals" and the Infantilization Mentality

In the statistics on "services desired from the company" (Huishang Futures, 2019a), although 12.8% hope to receive basic knowledge training, a significant portion explicitly request:

"Specific buy and sell points,"

"Teachers leading trades,"

"Accurate market forecasts."

Such demands reveal a deep-seated infantilization mentality. Although 95.34% recognize that futures are a "skill requiring learning" (Huishang Futures, 2019a), in practice they yearn to relinquish decision rights and seek an omniscient and omnipotent "authority" to take responsibility for outcomes. This not only eases the anxiety of decision-making, but also prepares a future scapegoat ("It was the teacher's call that was wrong, not me") in the event of further losses.

3.5. The Prevalence of Fear of Missing Out (FOMO)

(1) Near-Universal Anxiety

Data from Huishang Futures (2019a) indicate that the vast majority of respondents (over 90%) report anxiety after missing out on opportunities. This suggests that fear of missing out (FOMO) is a widespread "epidemic" among retail futures investors.

(2) FOMO's Destructive Impact on Stability

FOMO is one of the core drivers undermining trading stability, acting through two main channels:

Chasing rallies and dumping bottoms: Entering at the tail end of moves due to emotional impulses, leading to buying at the top and selling at the bottom.

Revenge trading: Treating "missed profits" as "actual losses" (a mental-accounting bias). To "recover" these missed profits, investors subsequently enlarge leverage or lower entry standards, thereby destroying their original trading plans.

3.6. Perceived Service and Technological Dependence

(1) Satisfied Tools, Unsatisfied Accounts

According to the satisfaction survey for the first half of 2022 (Huishang Futures, 2019b), clients rate Huishang Futures' basic services quite highly:

Trading software speed: 8.86

Trading software stability: 8.88

Human customer service: 9.28

This shows that retail investors' losses are certainly not rooted in poor infrastructure. On the contrary, highly convenient mobile trading software (apps) may to some extent fuel "frequent trading" and "itchy hands." Extremely low trading friction (quick order placement, real-time market monitoring) makes impulsive trading easier than ever.

(2) Content Consumption Preferences

National survey data (China Futures Association, 2022) show that, in terms of investor-education formats, video content (75.4%) and graphic content (65.7%) are much more popular than purely textual content (46.4%). This reflects a fast-food preference in information acquisition. Investors are more inclined to watch short videos like "Learn K-lines in 5 minutes" than to read in-depth systematic books. Such fragmented learning is unlikely to build a coherent trading logic, further intensifying the dangerous state of "knowing a little (technical indicators) but not the whole picture (money management)."

4 DISCUSSION

4.1 Formation Mechanism of the Stability Paradox

Synthesizing the above analysis, this paper summarizes the formation loop of the "stability paradox" as follows:

Incentive: Desire for rapid wealth growth (ideal: stable sudden wealth) + easy access to leverage tools.

Bias: Overconfidence leads to all-in trading (means: aggressiveness).

Shock: Market volatility triggers loss aversion (stubborn holding) or FOMO (chasing rallies).

Dissonance: The huge gap between actual losses and self-expectations produces cognitive dissonance.

Defense: Instead of correcting behavior, investors alleviate anxiety via external attribution (blaming big players, blaming software) or dependence (seeking trade recommendations).

Cycle: Erroneous attribution results in the wrong "remedy" (learning more techniques, switching to faster software), thus ushering in the next round of losses.

4.2 Policy and Industry Recommendations

Given this deeply entrenched behavioral pattern, the traditional "risk disclosure statements" (data show that 90.4% have read them, yet they are clearly ineffective) are no longer sufficient (Huishang Futures, 2019a). The following recommendations are proposed:

Shift from "technical training" to "behavioral correction": Investor-education content provided by futures companies should reduce the emphasis on predictive technical indicators and instead stress mindful trading, emotion management, and the mathematics of money management. The core of education should not be "how to predict the market," but "how to accept losses."

Behavioral "nudges" at the technical level:

"Cooling-off period" functions in software: When frequent losses within a short period are detected, the system should forcibly display risk alerts or temporarily lock opening new positions.

Mandatory stop-loss options: Require setting stop-loss prices when opening positions, otherwise orders cannot be placed (pre-commitment strategy), using technical means to compensate for human weakness.

Redefining "service": While clients crave "specific advice," futures companies should resist providing spoon-feeding services and instead offer "post-trade diagnostic services" — using big data to analyze clients' trading histories and generate personalized "trading health reports." By visually demonstrating the exact monetary losses due to "not cutting losses," data can be used to break down their cognitive defenses.

5. CONCLUSION

The "stability paradox" is a systemic misalignment of psychology and behavior among China's high-leverage retail investor community. Although they subjectively pursue bond-like "stable returns," in the high-leverage, high-volatility environment of the futures market they exhibit highly risk-seeking behaviors driven by loss aversion, overconfidence, and attribution bias.

The data in this study show that the 46% "plan–execution" gap and the 35% "stop-loss barrier" are the direct causes of this paradox. As long as investors continue attempting to eliminate uncertainty by "predicting the market" rather than coping with uncertainty by "managing themselves," this paradox will persist. For the industry, recognizing retail investors' cognitive limitations and shifting from merely providing trading channels to offering behavioral-finance support tools will be key to future differentiated competition.

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