NORCAL WEBINAR

Is Your Brain Sabotaging Your Investments?

Hints from neuroscience and behavioral economics

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Many decisions are actually made by the unconscious decision centers of the brain. You are not even aware of the underlying reasons, which may not be rational. The rational conscious decision center may cherry pick evidence to conform to the decision already made.

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Tonight we'll cover some brain tendencies that can **hamper** your investment decisions

AND

Consider ways to **counteract** these natural tendencies.

This webinar will not cover all the ways the brain takes decision short cuts that may be irrational when applied to investing.

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Before getting started let's take a *quick poll* of our audience on their investment decision making process.

When making investment or spending decisions, the old adage
"A dollar is a dollar is a dollar"
is embedded in my decisions.

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A Dollar is a Dollar is a Dollar …

NOT TO YOUR BRAIN!

Why does your brain treat some **dollars** **differently**?

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Two Brain Tendencies Contributing to Unequal Treatment of Dollars by the Brain Are:

LOSS AVERSION

Your brain is naturally set to avoid losses.
The pain from the loss of a dollar is greater than the joy of a dollar gained.

MENTAL ACCOUNTING

Your brain puts your money into separate accounts.
Different accounts have different approved uses.

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Consequences of Loss Aversion

- Difficulty selling losing positions.
- Adding to losing positions.
- Choosing very conservative investments.
- Selling winners quickly to lock in gains

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Consequences of Mental Accounting

- Difficulty investing some money.
- Easy consumption of some money.
- Choosing inappropriate investments for some money.
- Feeling some money not really yours.
- Not taking savings on some expenditures

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Countering Loss Aversion and Mental Accounting

- Try to reframe losses as gains
  - More money to invest in better prospects
  - Tax savings from realizing losses
  - Reframe question to “Would I invest in this company now?”
- Try to shift money between mental accounts
  - Don’t decide immediately on uses for “fun” money
  - Think “If I had earned this money, would I spend it this way?”

Let’s pause for questions

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Other Brain Irrationalities That May Hamper Investment Decisions

Confirmation Bias

Expert Opinion

Herd Instinct

Avoid Extremes

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Confirmation Bias, Expert Opinion and Herd Instinct are related tendencies.

In confirmation bias, the unconscious decision centers make a decision and the conscious decision centers cherry-pick evidence to support the decision.

In Expert Opinion, an opinion is considered correct because of the experience or expert knowledge of the person expressing the opinion. Contrary evidence is considered trivial or irrelevant because it was discounted by the “expert”.

For Herd Instinct, an opinion is considered correct because everyone is doing it. How could so many people be wrong?

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Some Possible Consequences of Confirmation Bias, Expert Opinion and Herd Instinct

- Decisions are made on incomplete data.
- Investments purchased that do not match your needs.
- Investments purchased that do fit your risk profile.

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Suggested Counteractions For Confirmation Bias, Expert Opinion and Herd Instinct.

- Actively look for evidence contrary to your thesis.
  - Ask “How could I be wrong?”
- Check to see if evidence is being ignored or discounted.
- Be especially diligent when you are very confident of a decision.

Let’s pause for questions

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AVOID

EXTREMES !

Your brain tends to dislike extremes.
It will tend to choose a middle choice even if it has disadvantages.

SnobbieA
$600

Elite 1
$400

Best 1
$150

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Investing Pitfall of Avoiding Extremes

- Choosing an investment from a group of choices mainly on price.

Countering this tendency

- Consider other measures of value than price.
  - PE ratio
  - PEG ratio
  - Return on Equity

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The Brain Has Many Complex Decision Short-Cuts That May Affect Investing Decisions

Some will be irrational when applied to investing.

You can reframe questions for better decisions.

Be aware of the irrationalities and take counter measures.

This was only a small sample of brain tendencies.

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For More Information

The Behavior Gap – Simple Ways to Stop Doing Dumb Things with Money
Carl Richards

Why Smart People Make Big Money Mistakes … and How to Avoid Them
Gary Belsky and Thomas Gilovich

How We Decide
Jonah Lehrer

Predictably Irrational – The Hidden Forces That Shape Our Decisions
Dan Ariely

Thinking, Fast and Slow
Daniel Kahneman

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Almost done! Let's take another *quick poll* of our audience on their investment decision making process.

When making investment or spending decisions I do not have any brain short-cuts that bring in possibly irrational processes.

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PostScript
Removing **Emotion** From Decisions

It is IMPOSSIBLE.

The emotional centers of the brain are essential to decision making. Decisions are not possible without functioning emotional centers.

Seek to control emotional response, especially greed and fear, in investing decisions.

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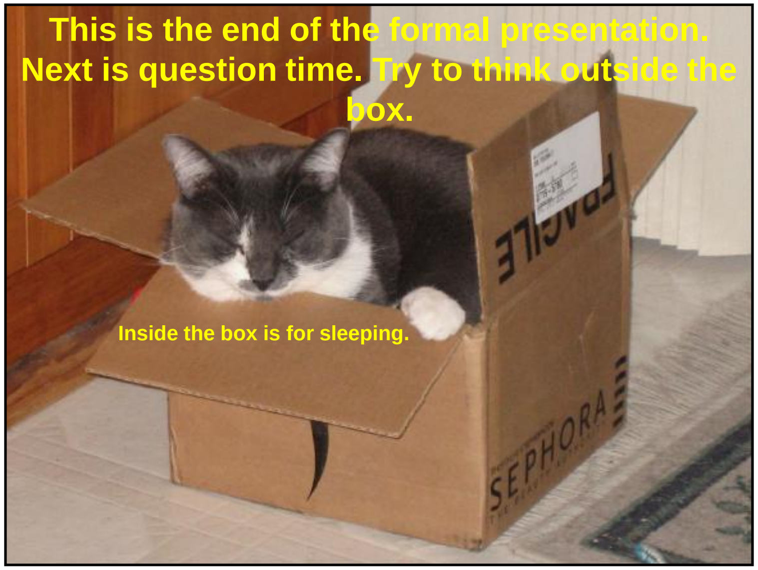

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QUESTIONS?

Aren't some of these contradictory?

What did you mean by that?

How can emotion be essential for decision making?

How do I apply this to my investing?

I'm confused by this item.

Why would the brain be irrational?

If you think of a question later email me at
rmalley@sbcglobal.net

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