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• One Man's Opinions – Spring 2013

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Statistics show that the stock market, on average, returns approximately 9-10% per year over time, including dividends. Yet the average investor, operating on their own, manages to capture less than three percent annually. Obviously they are doing something wrong, and these mistakes have been identified as originating from making decisions from their emotions. They buy when stocks are high and everyone around them has been "getting rich" in the market (or in real estate, gold, or tulip bulbs). They sell in a panic when markets break and plummet, usually somewhere near the bottom of a decline. Why do some people do this to themselves?

In previous editions of this missive I have written extensively about the human brain and how it functions and how it impacts our investment decisions. New readers can find these editions posted on my website, *www.tommcallister.com*. In this quarterly letter I continue sharing my thoughts as to how our emotions, triggered by the amygdala, our lizard brain, interfere with our using rational thoughts and beliefs in our investing decisions.

Our brains have two "minds." One is the amygdala which operates independently and is there to warn us of danger and give us the necessary hormones to escape from whatever threatens us, either physically or abstractly, such as our relationships or our financial condition now or in the future. Let's call this our emotional mind. The other mind is our rational mind, which takes into consideration our knowledge, wisdom, life experience, and judgments as to the future.

Making good decisions is not a matter of heeding one mind and ignoring the other. The brain is designed to work as a whole, integrating its emotional and analytic capacities. If someone is upset or rattled about their finances they tend to swing too far in one direction or the other. The best approach, I have found, is to take a middle path in which we use both our head and heart. This means using our prefrontal cortex, the part of our brain which receives and processes verbal and nonverbal input from both hemispheres of the brain. Anxiety disrupts this process and triggers the amygdala to flood our bodies with the stress hormone cortisol, putting the prefrontal cortex out of commission.

This condition is, of course, the absolute worst time to make decisions about our health, loved ones, or our financial condition, especially investing. Acknowledging our emotions is the first step toward integrating them. Vague discomfort and fears pale in their impact on us once we identify them and their sources. They can serve a real purpose, but we need to learn to feel them, report them, perhaps to our financial planner or investment manager, discuss them, and determine an appropriate course to take. This is "easy for me to say," hard for most of us to do.

Let me make some suggestions based on the above considerations:

1.) Avoid making decisions while under stress. We humans tend to overestimate our ability to make rational decisions. But the reality is we may have only a few hours each week of quality thinking time to make difficult financial decisions since the prefrontal cortex (the center of our conscious decisions making) is small and tires easily.

2.) Consider your real needs and goals when making financial decisions. Avoid "tips" and salespeople trying to get you to buy products which may or may not fit you.

3.) Unresolved issues create major stress in our lives. We need to work through our emotional problems to relieve stress and get emotional release. Prayer, meditation, physical exercise, and other "calming" behaviors do actually work.

4.) Seek advice and guidance from someone who is calm and rational about these matters. Generally an experienced investment professional has learned to come to peace with his or her emotions. This stable condition is picked up by their clients. By all means, avoid CNBC and other financial media who trigger excitement and fear with their short term focus on the financial news. Remember their business is selling advertising, not making you money.

5.) We humans process information in different ways; verbally, visually, and kinesthetically (by physical movement). I thought for most of my life I was a visual since I read almost constantly. I still do. But I discovered several years ago that I take in information both verbally and visually, but I "absorb it" kinesthetically. I "feel it" once I get it! Like when I am starting these newsletters and blogs.

6.) The better we understand our brain and how it functions, the more effectively we can manage our emotions. Suppressing them tends to intensify them over time. The best way, as mentioned above, that I find is to recognize what I am feeling, report those feelings to someone else, and then process them appropriately.

7.) Do not discount your emotions in making decisions; they are a vital part of it. We often tend to assume that a gut (emotional) response cannot be right because it conflicts with a logical weighing of the pros and cons of an issue. But if we cut off the emotional part of our brain we may well make overly optimistic decisions, lacking in human values for example. The important thing is to be aware of both parts of our brain when they are in conflict. It may be that an emotional response is our brain is actually warning us of something, or intuiting it, which might be helpful in the situation we are faced with.

8.) Be aware of the lessons of behavioral finance. We advisors often note that client's are not focused on "the now" when determining whether to buy or sell an investment, rather than its present and/or future value. Waiting until I can "break even" on a losing investment to sell it is often the wrong thing to do. It may never get back to what you paid, or it takes so long you would be far better off having the money elsewhere. By the same token, waiting for a market listed investment to go back to its "bottom" may be equally fruitless. If it is attractive now, why do you believe it will go down? If you believe it will go down, why do you even consider buying it?

9.) Practice ways to overcome your own anxiety. Fear is the first and most primal emotion. Our amygdala is programmed to be "on alert" for danger very waking moment. Fear and the need for security supersedes everything else and are highly stressful. Back off from a decision when you are feeling stress. Taking deep breaths, with the exhalation being twice as long as inhalation, reduces your stress. Noticing that you actually feel all right in the moment accesses signals from your body to brain that all is well. Destressing has a hormonal effect on the body which will affect how well we can cope with whatever decisions we are facing.

10.) Be aware of what time of day you function best from both minds. I am a morning person. I arise relatively early, and do my best work before Noon. Others are night people, only coming alive after the sun goes down. Still others peak late in the day. Know when you are at your best and when your thinking is clearest. For example, I almost always start my blogs and newsletters first thing in the morning. My mind functions well, my creativity is at its peak, and I make fewer mistakes. By the same token, I edit better later in the day. It all depends on the person. None of us is alike.

Careful awareness of our feelings as well as our thoughts should lead to better decisions and better results in our financial affairs.

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