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- One Man's Opinions – Summer 2013

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Why Do We Do The Things We Do?

For several years now, since the awful market debacle of late 2008-09, I have been attempting to understand why humans behave the way we do in the securities markets. As I uncover more information I share it with my readers in these quarterly newsletters. Previously we have covered fear and anxiety and its affect on our "lizard brain," our amygdala, in some detail. In this missive I share some additional thoughts and opinions, including the dangers of being overly excited and/or exuberant.

In a recent interview Douglas Lennick, a fellow CFP, commented at length from his book "Moral Intelligence, Financial Intelligence." Here are some of his observations that I found interesting and helpful. I have edited as well as expanded on them from my own experience.

We humans have been hard wired since ancient times regarding greed and risk taking. It seems we are also similarly hard wired at the other end of our emotions, excitement and exuberance. The current question is how can we change this wiring to more appropriately cope with modern life?

To begin with we need to understand why we are wired the way we are, that this wiring is triggered by our emotional reactions. When things happen outside us, emotions are stimulated. If we get scared or angry our danger system is activated. When we feel excitement or exuberance, our opportunity systems are activated. These are chemical activities going on in the brain. The "hooker" is that when one of these systems is activated it disables the other.

So how can we change our brains? To start with, practice does not make perfect; rather it makes permanent! Whatever we think or do repeatedly gets wired into the "habit center" in our brains. After doing so we can use our mind, which operates inside our brain, to decide what to think in order to change our physical brain and its responses. This is called "neuroplasticity." When we do this we are molding our brains, literally creating and wiring new neurocircuits. One of the things we want to wire into our brain is a habit of being self-aware at this very moment, not retrospectively.

All the great spiritual teachers teach us to "live in the present, in the now!" Doing so facilitates this self awareness of the moment. I have been on this particular path for over 20 years. I can report that I am making some progress, but am certainly nowhere near perfect in this aspect of my life. But a lot of lessons I've learned are now permanent!

We need to achieve self awareness while we are actually doing things. Fortunately we can rewire our brains to make a habit of being aware of what we are feeling and doing right now, paying attention to our reality multiple times during the day. If we practice doing this, it will become permanent. It can profoundly change our lives and it is how we can adjust our brains to deal with the complexities of modern life.

I think you might find the following interesting. Just *coincidentally* I received this particular daily meditation just prior to finalizing this newsletter. Take a look please.

One comes, finally, to believe whatever one repeats to one's self, whether the statement is true or false. -- Napoleon Hill

Our inner dialogue can have awesome power. It often determines the behavior that defines who we are. We do, of course, have some choice as to the direction this inner dialogue will take. It's as easy to affirm our self-worth with positive messages as it is to tear ourselves down with negative ones. And yet, many of us fall so easily into negative patterns of thought.

As with so many aspects of our life, we become proficient at what we regularly practice. The regular, preferably daily, use of positive affirmations can make such a profound contribution to our well-being and willingness to grow and learn that it can change the course of our life. All we have to do is develop the discipline to make these positive messages habitual. In so doing, we bring our vision of ourselves in line with God's, Who accepts us completely as we are.

I have long been puzzled by the frequency of disconnects between peoples' goals and how they actually behave. Why the conflict? Apparently it is largely because our stimuli influence our reality, and they stimulate our emotions first! When our danger system or our opportunity system is turned on due to this chemical activity, it disables the other system, and we make decisions without using all the cognitive capabilities available! This creates a disconnection between our goals, which require commitment over time, and our instantaneous response to external stimuli, which is, of course, in the present.

During and after the 2008-09 meltdowns I had several clients make decisions to exit the stock markets at exactly the wrong time. They fled to cash, or worse, to the lure of annuities and their largely inaccurate "safety" at high costs. Annuities have their place, but they normally carry very high sales commissions and fees. Then the insurance companies must then invest the buyer's funds in available fixed income opportunities. At current historically low interest rates these returns are mediocre at best, terrible at their worst. For most of us, annuities are not a good investment these days.

We ordinarily think of people behaving irrationally out of fear and/or anxiety. But such behavior can also stem from being overly excited or exuberant. We financial planners have had to learn to recognize this type of behavior in our clients as well. Greed will stimulate irrational behavior in the same way that fear does. Seeing such behavior after the fact is easy. In my profession it is called 20/20 hindsight. It is always perfect! The hard part is to become aware that in certain market climates and actions this could happen. The dot.com boom of the late 90s and early 2000s comes to mind.

Back then price earnings ratios, the fundamental yardstick we use to determine the value of stocks, were at ridiculously high levels. Even more ridiculous were startup stocks which had NO EARNINGS AT ALL and were being driven higher and higher based on such notions as "potential market share." Do you recall the "internet grocery stores" that were going to transform the way we buy our groceries? We would just email in our order with our credit card information and it would be delivered right to our doors. It didn't happen! Many speculators lost a lot of money betting that it would. There were dozens of such examples.

Most professional investment managers I know of were very cautious about the exuberance and excitement that abounded back then. One I know of lost half their clients to inexperienced stockbrokers, who were claiming they could produce 20% annually or more. I know of one case where the broker verbally “guaranteed” a 20% annual return. The client bought into this nonsense even though his account had gained 17% with us the previous year. Of course the broker never put it in to writing, co-signed by his branch manager, as I suggested the client ask him to do. Such guarantees are not allowed in the securities business! Back when I managed a stock brokerage office, if one of my brokers made such a guarantee, even verbally, and I found out, he would have been fired immediately! No discussion, no excuses! There are NO guarantees in our business!

Examples of such exuberance and excitement are difficult to find in the stock market these days. But I suggest the run up in gold prices in the recent past to over $1700 an ounce could well qualify. It since dropped back over 30% from its high, selling at less than $1200 an ounce as this is written. Other commodities have demonstrated similar results in the past couple of years.

The granddaddy of them all was, of course, the housing boom and bust of the mid-2000s. Stimulated by the U.S. government and Congress, and reinforced by Wall Street, housing prices in certain parts of the country were bid higher and higher, enabled with very loose lending standards by the various mortgage makers. When the bubble finally burst, as it had to do, it resulted in the worst financial meltdown since the Great Recession of the 1930s. We are still feeling the repercussions. The mantra of the times was “housing prices never go down;” so much for that exuberance!

Our capitalistic system corrects such malfunctions over time. But investors can be badly hurt, even financially ruined, when it does so. I believe we financial advisors are morally obligated to point out the risks involved in such bubbles. But we are often ignored, or even worse, swept up in the craziness ourselves; especially our younger colleagues to whom these disasters are ancient history. I recommend investors pick advisors, whether they are investment brokers, financial planners, or investment mangers, who have weathered some storms. In so doing they have necessarily (in order to survive in the business) “rewired” themselves. This usually takes ten or more years of experience. Newer advisors can “borrow” such experience by forming a partnership with a senior experienced advisor. Thankfully, this is becoming more and more common in financial circles.

I welcome your questions as well as your feedback and comments on this and other aspects of these newsletters and my weekly blogs. They are my attempt to share with anyone interested in my knowledge, ideas, and experiences. All are published on my website, tommcallister.com.

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