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VOICES FROM THE INDUSTRY

Stock investing means navigating emotional mind fields

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This has been a dizzy stock market, maybe even ill, but it isn't terminal. Learning how to manage one's own emotions while investing is an important part of success. And, the most crucial factor is practicing realism over optimism, instead of the reverse. Hope is helpful in most areas of life because it gives us optimism and a reason to live, but in the investment arena, it can quickly drive our portfolio into negative territory. **Our desire for excessive investment returns can overshadow realistic probability.**

This means we either don't know what is reasonable to expect, or we overlook it because hope prevails over realism. As an example, investors often fall prey to "pump and dump" schemes by responding to Internet solicitations to buy a low-cost stock that is reportedly poised to increase in value. Then, the Internet expert waits until his innocent prey takes the bait and "pumps" up the price of the stock. This is the queue for him to sell and make a profit because of an artificially inflated stock price. His unwary Internet victims are left with a stock that falls when it becomes apparent that the news about the projected gain was untrue. Here, Warren Buffet's words ring true: "It is optimism that is the enemy of the rational buyer."

There are two corollaries to "**optimism over realism**." One is overconfidence. An overconfident investor thinks he can beat the market because he assumes he can pick stocks that are winners. Therefore, he overtrades. Studies show that men, overall, make less in the stock market than women because they buy and sell stock more often. These researchers attributed their findings to overconfidence-characteristically found more in men than women. As Warren Buffet says, "Much success can be attributed to inactivity. Most investors cannot resist the temptation to constantly buy and sell."

Another associated consequence of "optimism over realism" is what Bailard, Biehl and Kaiser Communications Group called the "celebrity." These are people who are very successful and busy. They don't have time to do investment research. The natural conclusion is that they are lacking well-thought-out ideas about how to handle their own investments. Therefore, they latch on to whatever hot topic they are exposed to through the media or their contacts. They often take tips and act on them.
These celebrity investors are especially vulnerable to the salesman who is skillful at making projected benefits appealing, though they never materialize.

Another mind-field, but one that can be deadly, is **excessive risk-taking**. Individuals who are prone to risk-taking behavior are stimulating their pleasure center, the nucleus accumbens, when they make perilous financial choices. Activation in the nucleus accumbens is associated with a positive anticipatory affective state, which makes the investor feel good. This is caused by dopamine release.
Geneticists Kenneth Blum and David Cummings label this drive for excessive risk-taking "the reward deficiency syndrome." People with this condition are unable to get sufficient satisfaction from the usual rewards in life and need to up the ante. The geneticists have identified a variation of a normal gene that prevents dopamine from binding to cells in the reward pathway. Therefore, the satisfaction usually felt with the release of dopamine is diminished and must constantly be reinforced. One way to do this is to constantly take risk. Although the studies to date have focused on addictive behavior, there may be a variation of the condition that contributes to financial risk-taking or other varieties of the same danger

seeking personality such as hazardous sports. The problem for the risk-prone investor is that risky behavior rarely earns better investment returns over time. Usually, it simply means that more risk is taken for the same or often less return.

As Warren Buffet says, "An investor needs to do very few things right as long as he avoids big mistakes." The positive news here is that recognizing one or more of these mind-fields in our own behavior mean we can deal with it to produce better investing results.

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