

Viewpoint

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Can emotion benefit investment decisions?

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Most people think emotions hinder rather than benefit successful investing. This common conception, though, is being challenged. Evidence supports just the reverse. Lack of any emotion in financial decisions means the result is worse, rather than better, according to neuroscientist Antonio R. Damasio. He first made this point in his seminal book, "Descartes' Error." In the text, he talks about Elliott, a patient, who couldn't make advantageous decisions for himself because he lacked feeling. This was due to a neurological deficit after an operation to remove a brain tumor.

After the operation, Elliott appeared normal in most ways. He could talk, walk and still had his knowledge base. Nevertheless, he could not hold a job as he had before the surgery. The problem appeared to be that he could not prioritize and stick to the task at hand. What had happened to cause this was not clear. The only hint Damasio had to go on was that Elliott confided to him that he knew his feelings were changed from before the operation to after the procedure. Issues that had once caused an emotional reaction in him now made no impact at all, either positive or negative. It appeared this is why he was unable to make effective decisions. He had no feeling that the decision affected him one way or another.

This observation sent Damasio and others into a series of recent experiments to investigate this problem: Just how important is emotion when a decision is made? They honed in on testing risk-taking, because that is an important factor in most decisions. In their experiment, the researchers used a card game to assess the decision-making process. They compared normal subjects to braindamaged patients with an injury in a specific area of the frontal lobe that deals with emotion. What Damasio discovered was both unexpected and dramatic.

People make better decisions when they use emotion than when they don't. The "normal" subjects responded to feedback from their body (measured by a physiological stress monitor) when they made losing choices. Then, they attenuated that behavior. The brain-damaged patients, on the other hand, did not receive this physiological feedback because their brains couldn't register the emotion related to picking losing cards. Therefore, they continued the losing behavior.

The investigators clarified it this way: "In normal individuals, non-conscious biases guide behavior before conscious knowledge does." This non-conscious bias is what people commonly call an intuition or a hunch. When we make losing decisions, we know it even before our intellect springs into action. Then, we have a chance to modify our behavior

using this sixth sense.

In other words, emotions have their place when we make monetary decisions. Without them, we can't and won't decide what is best for our economic future. A famous example of this is George Soros, the famous financier. His son reported that when his father's back began to hurt after making an investment decision, Soros knew he had to reconsider. That is the ultimate sixth-sense feedback.

How can we use this research to our benefit?

Simple, by appreciating that our own emotions affect our investment decisions and implementing that information to our benefit. As Warren Buffet says, "It's only when the tide goes out that you discover who's been swimming naked." This is analogous to understanding what part our own emotions play when investing. Without this protection, we're swimming naked in a sea of competitors, at least some of whom understand what part their own emotion plays in their investing choices and use it to their advantage.

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