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"Sometimes Doing Nothing is a Good Thing"

By Craig Pulliam, CFP® and Michael Comstock, CFP®

Investors can pick up a magazine or go to any number of financial websites to find model investment portfolios. They're touted all over the place –often with cookie cutter simplicity- and figuring out the hype from the bona-fide is a challenge. But, you might be able to do it. Of course, *we* have a few things we do (e.g. using a broader range of investments) that may make for a superior mix. And these are tailored to clients' unique needs, as opposed to the cookie cutter approach. Too, we use powerful software and other tools not readily available to most investors, that help us measure and monitor risks. But, it would be hubris for us to claim that people don't have the intelligence and wherewithal to put something together that might work for them. At first.

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So, if piecing together your own investment mix is within your grasp, why hire a financial advisor to develop a portfolio and monitor it for you? The answer may have less to do with the investment-picking expertise of the advisor than it does with the *brain chemistry* of the investor. And that's one reason we get hired. You see, we may not have such a huge competitive advantage just because of the data we access . . . our advantage stems more from how we use this data, how we understand it, and how we have trained ourselves to overcome and sometimes disregard what our brains and body chemistry tell us to do.

What we're saying is that even smart people too often look at the wrong information and listen to the wrong signals when investing. Yet this is completely understandable. Because there is nothing quite like the way investing plays on our intellect and emotions. The stakes are exceptionally high. As investors, our success may determine what kind of college our kids go to, whether we can upgrade our home, and whether or not we can afford a comfortable retirement. And we get a report card every day from the stock market headlines; a daily answer to the question, "Am I doing ok?" Often, the answers seem terribly fickle.

It's understandable that normal reactions to this assault of information are occasional concern, alternating with joy, and then dejection. Your feelings about politics, family, your job, and yourself all add to this emotional stew. Some people are able to separate and compartmentalize these things, or even to just turn their emotions off for the most part. But that's not the norm, and there are some interesting reasons why that's the case, and why we just can't help ourselves sometimes.

The fields of behavioral finance and neuroeconomics study how people process information and make financial decisions; and how our body chemistry and brains influence us and filter information both to our advantage and occasionally to our detriment. It's interesting stuff, and helps explain why we are sometimes our own worst enemies when it comes to making the right financial choices . . . and why investors sometimes choose to *act* when it's best to do nothing at all. A study by the University of Iowa (and others) published in the Journal of Neuroscience this year looked at how our brain's frontpolar cortex ("FPC") processes information and influences our actions in situations involving potential reward and our level of uncertainty and anxiety about whether the reward will be earned. Their subjects played slot machines!

The FPC deals with memory, our reactions to exploring new environments, and how we make decisions about the future. The authors found that people with normally functioning FPCs try diligently to look for patterns (in this case, which machines seemed to offer the better odds of payoffs), *even if there were no patterns at all*. Their brains didn't admit defeat and would often detect illusory patterns where none existed. Subjects with *some* damage to their FPCs simply used their cumulative experience with the machines, did not try to outguess when and where the payoffs would be . . . and they did better. The lesson here is that too often investors, confronted with the data-smog of financial and political news, believe that there is critical information being communicated, that there is some pattern or relationship to be discerned which . . . if they can just get a handle on it . . . will lead them to an action which will benefit their portfolio, or help them avoid a financial loss. By "acting" they often make the wrong choice. Inaction might have been better.

The amygdala - located near the brain stem - also affects our judgment. It is that ancient part of the brain that is responsible for instinctive and emotional reaction. In ancient humans it was the part of the brain that would assess imminent danger from predators and tell us to flee. In modern humans, it remains hypersensitive to what we deem as negative and stressful; actively processing even as we watch the news or read the headlines. And the amygdala triggers reactions that may be irrational, the products of overblown fears. The instinct to bail out at the first sign of a threat –helpful if you're facing a sabre toothed tiger- isn't so helpful in financial markets, which can scare us 3 or 4 times a day.

In February of 2014, the Proceedings of the National Academy of Sciences published a study about the effects of the chemical cortisol (from the adrenal gland, but you probably already knew that) on the brain and how it affects risk taking. Cortisol levels tend to rise in an environment of increasing novelty, uncertainty, and uncontrollability . . . words that well describe the financial markets. In a previous study the authors noted that professional stock traders had a 68% increase in the level of cortisol over short durations when market volatility increased. So the authors decided to look at average citizens in the recent study.

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They found that over longer periods of a week or more - when they increased cortisol levels in subjects – high cortisol levels led to dramatic "risk-averse" behavior (as compared with a control group). All subjects were confronted with a series of lottery choices where the odds of greater winnings were lower than the odds of lesser winnings. The group with chronically higher cortisol exhibited a 44% lower willingness to accept the risk for higher payouts, even when the odds were essentially the same. The authors suggest that –in financial markets- this points to the preference of stressed out investors to sell stocks in favor of investments that are perceived to be of lower risk. The authors believe such wide-spread risk aversion, precipitated by rising stress hormones such as cortisol, may *contribute* to levels of market volatility such as we saw in 2008-2009, in what was termed "irrational pessimism."

Our brain is amazingly efficient. Throughout our development as a species it has helped us survive predators and cope with an uncertain world. We are wired in such a way that stress often demands action. But, in the financial world this can work against investors seeking meaning and causality in what is really unknowable and unpredictable. This is why the average investor made 2.3% per year over the last 20 years (Dalbar, JPMorgan) –versus an S&P 500 Index average of 8.2%- and why frequency of investor portfolio trading is reported as inversely correlated with investor return (Barber and Odean).

Know yourself. Understand that to be human and an investor is to occasionally feel profound stress. Feeling anxious about your money is ok, but trying to "fix things" in the uncertainty of the moment may not be. And *that's* a major reason people need us. Sometimes we'll say "do nothing" and that can be the best advice you'll get.

Craig Pulliam and Michael Comstock are CERTIFIED FINANCIAL PLANNER™ professionals practicing at 112 Westwood Place, Suite 310, Brentwood, TN. They own Premier Asset Management and are registered representatives and investment adviser representatives with/and offer securities and advisory services through Commonwealth Financial Network: A Registered Investment Adviser, Member FINRA, SIPC. Fixed insurance products and services offered by Premier Asset Management are separate and unrelated to Commonwealth. We can be reached at 615-777-2125.Back issues of our Commentary may be found at www.premiercares.net