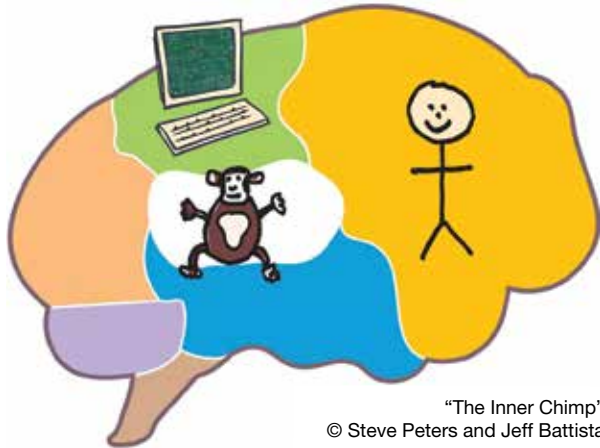


INVESTORS AND THEIR DECISIONS (6)

A series of articles, this one being the 6th, addressing investors and their decisions. In particular, whether factors other than rational considerations play a role in the investment decision process and if so, what the practical consequences and applications are for investors. This is the second article addresses managing these other factors (biases).



MANAGING YOUR MIND—THE CHIMP WITHIN US



In my last article, I suggested a practical remedy for investors to protect themselves from allowing biases to hinder investment results: work with a portfolio manager and/or a well formulated investment policy. In this article I want to delve a bit deeper into 'the workings of our mind' and introduce readers to a theory that is currently being successfully used in top sports but lends itself well to

fruitful investing too.

It is a theory, credited by - amongst others - Sir Chris Hoy, Bradley Wiggins and Victoria Pendleton (all Olympic gold medal winners in cycling) to have contributed to their successes (1). This theory was developed by Dr Steve Peters and published in his highly readable book "The Chimp Paradox" (2). Let's see if investors can benefit from the application of this theory!

Note : I do not claim in any way to represent Dr Steve Peter's views, nor to have his consent to my interpretations. For a full understanding, readers need to read "The Chimp Paradox" themselves.

In my previous articles addressing biases and the notion that investors often make decisions that were not necessarily based on rational considerations, I often refer to 'behavioural finance'. Dr Steve Peters is a psychiatrist and certainly not known for

contributions to the realm of behavioural finance. However, Dr Peters begins with an explanation of how our brains work, and offers a working model that is not only easy to understand (3) but that can also be considered in the context of behavioural finance- particularly

the area of behavioural finance my articles have focussed on. Peters introduces us to the part of the brain he terms the "Chimp". The "Chimp" refers to one part of our brain (the limbic brain) that works like an "emotional machine" (4). More interestingly, this emotional

part of our brain, once activated and in motion, is ever so strong and works 5 times faster than the more 'human' parts of our brain (5). The "Chimp" is so called because its workings show many similarities to the behaviours of chimpanzees.

The basis for the "Chimp's" thinking are impressions and feelings. Here are some elements that make up the "Chimp" "identity" (6):



- Jumps to an opinion
- Thinks in black and white
- Prone to paranoia
- Prone to catastrophic thinking
- Irrational
- Emotive judgement
- Responds to danger by attacking or fleeing (7).



The good news is (still staying with Peters' theory) that there are two further brain parts relevant to decision making processes: the "human" part and the "computer" part (8):

- The human part represents self-control, honesty, compassion, conscience, law-abiding, sense of purpose and achievement & satisfaction.
- The computer part thinks and acts automatically, using programmed thoughts and behaviours. It is a reference source for information, beliefs and values.

It is the interplay between "the chimp", "the human" and "the computer" which is responsible for the decisions we make. Essential for a "high quality interplay" is to familiarize ourselves with the "chimp" within us. Once familiar, we stand a chance to manage the "Chimp".

In the words of Dr. Steve Peters: "the chimp is an emotional machine that thinks independently from us. It is not good or bad, it is just a Chimp". (9).

THE CHIMP	INVESTOR BIASES
Jumps to an opinion	<i>investors betting a stock will go down after a period of e.g. five upside trading days</i>
Thinks in black and white	<i>investors not being able to handle ambiguity when it comes to the markets, investment opportunities and so forth</i>
Prone to paranoia	<i>investors who believe that any investment decision they make always will turn out bad for them</i>
Prone to catastrophic thinking	<i>investors fearing they will lose all when the market corrects strongly</i>
Irrational	<i>believing we can forecast stock prices, the markets, when we have got it right a few times</i>
Emotive judgement	<i>forming an opinion about a stock solely based on a chart</i>
Responds to danger by attacking or fleeing	<i>quickly selling when an investment goes down</i>

Troop instinct (10)

There are many characteristics to the "Chimp" within us; as I mentioned, Peters' book makes for a very fine read. One of them is that the "Chimp" has a strong need to be part of a "troop" (11). Herd instinct, following the crowd etc...sound familiar? Investors often making investment choices (buying, selling or holding) because friends/colleagues do...

So, what are some practical suggestions to help Investors keep their "Chimp" in check?

INVESTORS MANAGING THEIR "CHIMP"

Dr. Peters identifies three ways to manage our chimp: exercising it, boxing it and feeding it (12). For investors this can mean the following:

- 1) FEEDING THE CHIMP** : With small amounts, from time-to-time make a **clearly speculative investment**. For the "Chimp" it will function like a "banana" (13). And/or, again with small amount, follow a friend, colleague in a 'hot tip' investment.
- 2) BOXING THE CHIMP** : Recognize the "Chimp's" existence. **Do not fight the biases, the irrational responses when they come up. Instead, recognize them.** This will "re-assure" the "Chimp" of its existence, that it has a place (remember, chimpanzees are territorial). The Chimp can then be "boxed" (14), or set aside to allow investors to make considered decisions, which in many cases requires time.
- 3) EXERCISE THE CHIMP** : Have a **gambling account or a frequent trading account**, with a small part of your investable assets. An account where you allow yourself to act impulsively and quickly, following emotions and snap judgements. This kind of account will satisfy the "Chimp's" need to be active.

There is an important role for the computer part of our brain. I will tackle this in my next article.

Notes:

1) till 14) "The Chimp Paradox, The Mind Management Programme for Confidence, Success and Happiness" by Dr Steve Peters, published 2011 by Vermillion, an imprint of Ebury Publishing, a Random House Group company



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