

September 2009

FEELINGS

The subject of Behavioural Finance is becoming extremely well known in finance and investing circles; however, there remains a common misconception as to the role feelings play in our decision making process. Superficially it appears that our feelings cause us to make irrational decisions in situations of uncertainty and therefore the best cure for our attack on our feelings bias's is to cut them out completely. Until recent advancements in neuroscience this mistaken assumption would have been acceptable thinking; for investment decisions this is part of the solution, going forward far more comprehensive models will be required to outsmart our own smarts.

Allow me to take you on a journey of philosophical thinking before providing you with some scientific proof. Importantly these ideas have been generated from an excellent book by neuroscientist Jonah Lehrer called, *The Decisive Moment*.

The question of how we make decisions has been puzzling philosophers throughout the ages. Plato was one of the 1st to tackle the subject and used the now famous analogy of a charioteer being pulled by 2 horses. The charioteer being the rational brain with one horse representing good and the other bad combining to represent our feelings. *Plato wrote of the bad horse, 'He is of an ignoble breed. He has a short bull-neck, a pug nose, black skin, and bloodshot white eyes; companion to wild boasts and indecency, he is shaggy around the ears – deaf as a post – and just barely yields to horsewhip and goad combined'. What Plato was putting across is that the human job as charioteer is to keep going forward by keeping both horses under control and in so doing he pioneered the thought of the mind being separated into 2 spheres; reason and emotion as became accepted by western culture.*

René Descartes a leader of the Enlightenment era took a similar view and separated man into a soul representing the reasoning part of man, and a body full of 'mechanical passions'. His objective was to advance man as an entity that could triumph reason over emotion, with the Cartersian faith forming the basis of modern philosophy. Francis Bacon and Auguste Comte took this rational approach to society further as did Thomas Jefferson with his hope for America been governed by reason alone. Immanuel Kant took it a step further with the imperative that morality was rationality. Freud to embraced Plato's style of thinking by describing the mind as divided into a series of conflicting parts (id, ego) with the survival of modern society incumbent on man sacrificing the id (pleasure principle) for the sake of greater good.

To summarize; the line of thinking Plato and his followers supported was a utopia whereby man could use his reasoning sphere of the mind to completely shut out the emotional side, which after all was the cause of all mistakes throughout the ages. As Lehrer in his book puts it, 'the truth is far more interesting'. Science proves to us that in fact both sides are mutually dependent upon each other and without emotions reason wouldn't exist at all. Talk about turning accepted

philosophy on its head. In the story that follows Lehrer presents a case study where we learn how important emotions are in our decision making process.

In 1982, a patient named Elliot walked into the office of neurologist Antonio Damasio. A few months earlier, a small tumor had been cut out of Elliot's cortex, near the frontal lobe of his brain. Before surgery Elliot had been a model father and husband and held an important management job. But the operation changed everything. Although Elliot's IQ stayed the same he now exhibited one psychological flaw: he was incapable of making a decision. This made normal life impossible, routine tasks that would take minutes now took hours, with endless deliberation over irrelevant details. Damasio realized while in conversation with Elliot and later confirmed it with scientific brain testing that Elliot no longer had feelings.

At that time neuroscience believed human emotions were irrational and therefore not having feelings should make for better decisions. 'The charioteer should have complete control'. What we now know is that a brain that cannot feel cannot make up its mind.

To bring some closure to this journey it is worth understanding how the emotional brain system works according to neuroscience. 'The orbitofrontal cortex (OFC) is responsible for integrating visceral emotions into the decision-making process. It connects the feelings generated by the primitive brain – areas like the brain stem and the amygdala, which is in the limbic system – to the stream of conscious thought'. To say this in English the brain only feels comfortable making decisions when it experiences positive stimuli along the brain stem, rational calculation at this stage is irrelevant. The field of neuroscience is scientifically able to demonstrate how certain stimuli trigger emotions and how these emotions impact on the decision making process. This ability to understand brain computation through physiology makes the field of Behavioural Finance and Neuroscience codependent in helping us unlock some of the great puzzles of the human mind.

I would therefore like to suggest that we should only move forward with the task of blocking our bias's with the deeper understanding that our feelings are vitally important in helping us make decisions; it is just in the domain of areas of rational thought that produce certain brain stimuli and hormone release that we need to guard against our feelings. To negate feelings just because we are scared of the bias's they may represent is a one dimensional approach to the teachings of Behavioural Finance and is perhaps a misdirected objective - much like the philosophy taught by Plato and his followers. The future to better decision making under conditions of uncertainty may lie in the studies produced by Neuropsychology in conjunction with Behavioural Finance.

Michael Berman, Ph.D.