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THE FAMILY ISSUE
HOW TO BUILD A LEGACY OF WEALTH AND PURPOSE THAT ENDURES FOR GENERATIONS
What can investors do to avoid letting their ‘lizard brains’ take control?

By Steve Condos

Traditional finance theory assumes investors are perfectly rational beings who make predictable decisions based on maximizing wealth. However, everyone can pinpoint at least one instance when they, or those around them, failed to live up to that standard when investing.

This failure stems from a variety of cognitive biases—errors in thinking that influence how we make decisions. But is the muddying of rational decision making brought on by these biases inevitable? Or can we mount a defense against their deleterious effects?

There are a number of ways investors can attempt to control the biases that afflict them. The first, and perhaps most important, is to have a plan. At some point every investor should have sat down and developed an investment plan which incorporates, among other things, the investor's time horizon and risk tolerance.

Presumably, this plan was developed with a rational, long-term perspective in mind, which is important to remember during periods of market turmoil. In the midst of volatility it is imperative to trust your more rational self. Stick to your plan—you had it right the first time. If you do not have a plan, make one.

Second, ignore the investing-related “noise” that permeates our everyday lives. This noise takes many different forms: the multitude of talking heads clamoring for sound bites on television, news reports about the “death” of whatever asset class is doing poorly on a particular day or even a co-worker boasting about his or her own “incredible” returns.

All of this serves to scare or entice investors—to generate fear or greed. Am I missing out on the next big thing? Is my golf partner’s portfolio performing better than mine? Is the market going to crash? These are the questions this deluge of irrelevant information seeks to elicit. Those who buy into the questions may believe action needs to be taken immediately in order to avoid disaster or ensure they participate in the latest investment trend. This is precisely when reason is abandoned and poor investment decisions inevitably follow. Ignore what we like to call the cacophony of dunces.

The third piece of advice is to avail yourself of someone who can provide sound, objective advice during periods when you may be succumbing to your biases. This individual does not have to be a financial advisor, though we’ve conveniently provided our own contact information on the next page. It simply needs to be someone who can think rationally about your finances when you cannot. This person, or group of people, can provide valuable advice when your biases take over and lead you down the path of fear or greed. Sometimes you just need someone who can save you from yourself.

In his book, Mean Markets and Lizard Brains, Terry Burnham, PhD, used the term “lizard brain” to describe the emotional and instinctual parts of the human mind. While this part of the brain is helpful in other facets of life, it proves harmful for making financial decisions, since this is where our cognitive biases originate. These biases are part of being human and therefore cannot be completely eliminated. However, investors do not have to be ruled by them. Sticking to a plan, ignoring the noise and asking for help can protect investors from their own “lizard brains.”

Steve Condos is a Private Wealth Advisor with the Wealth Management division of Morgan Stanley in New York, NY. The views expressed herein are those of the author and may not necessarily reflect the views of Morgan Stanley Smith Barney LLC, Member SIPC (www.sipc.org). Morgan Stanley Private Wealth Advisors engaged Worth to feature this profile. Steve Condos may only transact business in states where he is registered or excluded or exempted from registration (www.morganstanleypwa.com/apollogroup). Transacting business, follow-up and individualized responses involving either effecting or attempting to effect transactions in securities, or the rendering of personalized investment advice for compensation, will not be made to persons in states where Steve Condos is not registered or excluded or exempt from registration. The strategies and/or investments referenced may not be suitable for all investors. (CRC 1142033 04/15)
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