The Stan Clark Financial Team's

PERSPECTIVES

An excerpt from "Perspectives" - Volume 9 - Issue 3

Behavioral finance

Introversion, extroversion and your finances

By Stan Clark - Senior Investment Advisor

In his fascinating book: *Thinking, Fast and Slow*, Nobel Prize winner Daniel Kahneman, described our minds as a dual system of fast thinking (System 1) and slow thinking (System 2). Our fast- and slow-thinking modes render us vulnerable to errors in making important financial choices. But there's another fascinating dual system we all share: *introversion* and *extroversion*. Our levels of these two can also expose us to poor judgments and bad investment decisions.

In *Quiet: The Power of Introverts in a World That Can't Stop Talking*, Susan Cain compares introversion and extroversion, including how they affect our financial decisions. Cain says we have two different brains. In our primitive or reptilian brain, located in the brainstem, anger and fear arise along with aggressive impulses. The other brain, our neocortex, gives rise to abstraction, reasoning, curiosity, speech and other qualities that make us human.

Our primitive brain watches for danger. It sends signals urging caution. The neocortex seeks novelty and pleasure. To help us find and experience these, it promotes risk-taking. The extent our neocortex heeds the warnings from our primitive brain determines our place on the continuum from extreme extrovert to extreme introvert. Cain cites studies indicating one-third to one-half of us are mainly introverts in our behaviour; the rest, mainly extroverts.

Extroverts are more reward-sensitive. Their brains produce more of (or are more sensitive to) the excitatory chemical dopamine. Extroverts gamble because winning gives them a rush. Introverts resist gambling. It's not so much that extroverts don't receive the same warnings from their primitive brains as introverts. But extroverts have innate biochemical mechanisms that let them ignore the warnings.

Extroverts tend to prosper in bull markets. They get excited. They decide and act quickly when presented with opportunities. They generally experience enough wins to offset any losses their rashness incurs.

Cain suggests it was the presence of so many extroverts in power at investment banks, brokerages and other financial institutions – as well as on the boards of large corporations – that led to the Enron-style meltdown of the housing and stock markets in 2007-2008.

That's large-scale extroversion. At the personal level, Cain offers the example of Alan, a 60 year old extroverted midwesterner. Through hard work, Alan and his wife accumulated a million dollars for their retirement. In 2008, hearing the government was going to bail out a troubled car company, Alan bought $100,000 of that company's stock.

But the bailout didn't happen right away. Rumours abounded that the company would be allowed to fail. Its stock plunged. In a classic example of anchoring and loss aversion, Alan clung to his stock, fixated on profits he still hoped to make.

The stock kept falling. Alan finally sold, losing most of his investment. Bailout rumours resurfaced. Alan bought in again. And again the bailout didn't materialize. Alan sold at a big loss. He bought in yet *again* and sold at a loss – until he had blown $700,000 of his nest egg!

What happened?

Most likely, Alan's reward sensitivity kept him focused on making a killing with his stock. He saw the potential rewards. He visualized a major coup. As an extrovert, he ignored the warnings raised over and over by the primitive part of his brain.

Had Alan been an introvert, he probably wouldn't have made such risky choices. Introverts tend to avoid big risks. In bearish markets, they fare better than extroverts.

The lesson: If you are highly extroverted, take a close look at your investment behaviour. Approach the market with rules and strategies based on objective data, rather than on emotions.

Investing with a disciplined, rules-based strategy – as we encourage our clients to do – removes emotions from your decisions. For extroverts, it's a little like having an introvert around to offer sound advice at crucial moments. ■

Stan Clark is First Vice-President, Portfolio Manager and Senior Investment Advisor for the Stan Clark Financial Team at CIBC Wood Gundy. Stan has direct responsibility for the team and oversees all areas of financial planning, investment selection and investment management.

CIBC Wood Gundy | The Stan Clark Financial Team
Where planning, investing and behavioral finance meet

Phone: (604) 641-4361 Toll free: 1 (800) 661-9442 Fax: (604) 608-5211 Email: StanClarkFinancialTeam@cibc.ca www.stanclark.ca