The Stan Clark Financial Team's

PERSPECTIVES

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Behavioral finance

The rider or the elephant: Who is really in control?

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In previous behavioral finance articles, I've discussed how our mind can be thought of as two minds. The first is our instinctive, intuitive mind; the second, our rational, deliberate mind. In this article, we will look at the first as an elephant and the second as the rider on the elephant. The intriguing question then arises: "Who is really in control, the rider or the elephant?"

The mind having two or more parts is not a new concept. Circa 400 BC, Plato used a chariot analogy, with the chariot driver trying to control two winged horses. The driver was our rational mind. The horses were our emotions and passions, both good and bad.

Buddha referred to a trainer trying to control an elephant. Freud suggested the mind was composed of the ego, the superego and the id.

In all these writings, the different parts of the mind are in conflict. The challenge for the rational mind is to control the instinctive mind, especially our instincts to do things that damage ourselves or others. We know smoking, over-eating, over-drinking, gambling and procrastinating are bad for us. Why do we keep doing them?

When Plato, Buddha and Freud lived, almost everyone had direct experiences with horses and other large animals, and could relate to the challenge of controlling something more powerful. In the 20th century, with the inventions of cars, airplanes and computers, we felt more in control. Accordingly, we shifted to the idea of the rational mind being in control of the instinctive mind. That approach dominated psychology, economics and finance from the 1960s to the end of the century.

Recent findings in behavioral finance and brain research, however, show that our instinctive mind has far more power and control over our thoughts and actions than we assumed. This is really a re-discovery of a truth known for centuries.

Prominent psychologist Jonathan Haight has done considerable research on current and ancient wisdom. In his wonderful book The Happiness Hypothesis, Haight asks: "Why do people keep doing such stupid things?"

Haight's favourite metaphor is the instinctive, intuitive mind as the elephant; the rational mind as the rider. The rider keeps the elephant walking up a path, but there are limits on his control. If the elephant is starving and sees food, or is thirsty and sees water – or even a terrifying mouse – it will ignore the rider and do what it wants. If the thirsty elephant bolts for the river, the rider may fool himself and others into thinking he wanted the elephant to go there. But he would be rationalizing.

In investing, we are exposed to many temptations from our inner elephant that can lead us astray. Our elephant likes to follow the crowd and buy into popular fads; it is terrified by short-term declines.

Trying to control the elephant once it latches onto a desire is almost futile. Far better to keep the elephant from being tempted in the first place. That's why, when you use a disciplined approach to investing, be wary about over-analyzing the strategy recommendations. The risk is that, in doing so, your inner elephant will get a whiff of bananas or perhaps a peek at the mouse – and you as the rider will find it very difficult to stay on the path to success. ■

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