The Stan Clark Financial Team's

PERSPECTIVES

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Behavioral finance

To improve investing, learn from Ulysses

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In my articles on behavioral finance, I often show how we are of two minds about – well, about almost everything.

Our *intuitive* mind skims information and seeks patterns. We then arrive at conclusions and make decisions, almost without thinking. Meanwhile, our reflective mind mulls over our intuitive actions. We often rationalize these intuitive actions according to our ingrained biases.

What can we do about this? In this article I will suggest that, to improve our investing, we can learn from the mythic Greek hero Ulysses.

I'll start by noting that, fortunately, our intuitions are often right. We are pretty good at judging other people's characters and sizing up complex social situations. But our intuitions can also lead us astray. They can be wrong in ways that cost us money – sometimes, big money.

Last month, I discussed how our emotions and biases affect our intuition, and how these biases won't disappear just because we know about them. Our intuitive biases are quite similar to optical illusions. Just because we know an optical illusion exists doesn't eliminate it.

The problem is, our emotional intuitive mind can have a tremendous influence on our judgement and decisions. It can twist our thinking, and cause us to buy and sell the wrong things at the wrong time. So, how to prevent our intuition from leading us astray?

Here's where Homer's story of Ulysses comes in. Do you recall this myth from your school days? The Greek warrior wanted to hear the songs of the Sirens, which no man had ever heard and survived. The Sirens' irresistible songs drove men mad, causing them to crash their ships on the rocks or jump into the sea and drown.

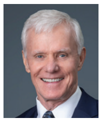
Cunning Ulysses entered into a contract with his crew. They would plug their ears with wax, tie him securely to the mast and then row past the Sirens. While within earshot of the Sirens, the crew, at Ulysses's behest, would ignore his pleas to be set free. This they did, and Ulysses became the first man ever to survive hearing the sweet-but-lethal Siren songs.

The essence of this story was that Ulysses recognized that he, like all other humans was susceptible to the Sirens songs. So he created a strategy so he could experience the songs while avoiding the tragedy.

When our team invests, we use a set of strategies that are, in a sense, a Ulysses contract. We set up your portfolio with a mix of equities and fixed-income assets tailored to your needs and your risk tolerance. Then we stick to the target, rebalancing when it gets too far out of line. This helps us avoid the lure of market timing, in our view a high-risk endeavour with low odds of success.

We select specific stocks according to objective data related to their intrinsic value and likelihood of appreciating. We don't buy according to hunches or transient news items that affect daily prices. This helps us avoid the temptation of speculating in fads and popular hot stocks that lack sound fundamentals. When investments no longer meet our criteria, our strategies move them out of your portfolio and into better ones, always following our rules and keeping your portfolio properly balanced. Since all the stocks we invest in meet certain standards, we increase the odds that your portfolio will rise in value – even higher than the very good long-term trend of the market.

Next time, I'll look at more tools for counteracting psychological biases. ■



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