

## THE STAN CLARK FINANCIAL TEAM'S

## PERSPECTIVES

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## Behavioral Finance

## THINKING: WE'RE OF TWO MINDS ABOUT IT

By Stan Clark, Senior Wealth Advisor

We humans are unique in our ability to think about how we think – and about how we make decisions. Yet through most of history, the human mind has been the ultimate black box. We could only guess and assume how it worked.

Since the ancient Greeks, the assumptions about how our minds work have revolved around a single theme: Humans are rational. We are deliberate and logical creatures.

Yes, there is an emotional side to us, but traditionally we've viewed that emotional side as an annoyance. We thought it was something that should be, and could be, controlled. Plato described our mind as being like a chariot, with the rational driver controlling and steering the emotional horses. Thomas Jefferson said the "American experiment would prove that men can be governed by reason and reason alone." This rationality came to define us. Rational was powerful and good, we decided. Emotional was weak and bad.

However, recent advances in brain research show otherwise. True, our rational and emotional minds differ greatly from each other. But each has impressive strengths and each glaring weaknesses. Moreover, the two minds are closely interwoven and influence each other far more than we are aware.

In many ways, our emotional mind is far more powerful – and useful – than our rational mind. Our emotional mind, the more instinctive one, evolved over several hundred millions of years. Our rational mind is a relative newcomer: It developed in our *homo sapiens* selves only about 200,000 years ago. In speed and complexity our emotional mind is like a super computer; our rational mind, more like a hand calculator. Our emotional mind allows us to make incredible decisions in an instant. It allows a golfer to strike a 1.68-inch diameter golf ball going 100 miles an hour to a tolerance of a half-inch. It allows us to know the answer

to a problem before we can explain why that answer is correct. In many complex decisions, especially involving physical speed, personal preferences and social situations, our emotional system is king.

Despite all its power, our emotional mind also has limits. Many of its workings are hard-wired into us, so it isn't flexible. It has biases that might have helped our ancestors millions of years ago, but give wrong responses to some of today's decisions. Its speed also means our emotional mind is short-term oriented. It responds powerfully to recent history, but doesn't learn well from the more distant past. It sees patterns where none exist. It doesn't grasp probabilities. It causes us to believe too much in predictions.

Our emotional mind communicates with us through feelings, intuition and gut instinct. These are not good or bad – it all depends on the circumstances and the decision we are facing.

The key is to know when to listen to those feelings and when to control or override them. It's also crucial to know that our logic is governed and affected by our emotions far more than we realize. Humans are gifted at rationalizing. We make up arguments and create or ignore information to support what are actually emotional decisions. It's easy to be fooled into thinking we are making a rational decision, when in reality we are being a chariot driver led by our horses.

It's important to know about the two parts of our brain – and to learn how we can use and control them in making good investment decisions. More about this in future articles.



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