Can Emotion Benefit an Investment Decision?

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Below is a short excerpt from the first of three interviews Doctor Mueller recently gave to Physician Reach Radio.   Broadcast times will be announced in upcoming additions.

Most people think that emotions hinder rather than benefit successful investing. This common conception, though, is being challenged. Recent evidence supports just the reverse.

Lack of any emotion in financial decisions means the result is worse, rather than better according to Antonio R. Damasio (at the University of Iowa Department of Neurology when he did the pertinent research).   He makes this point in his seminal book, Descartes Error, Avon Books, 1994.   In the book, he talks about Elliott, a patient, who couldn't make advantageous decisions for himself because he lacked feeling. This was due to a neurological deficit after an operation to remove a brain tumor, a meningioma. The tumor pressed on both of Elliott's frontal lobes from below.   The meningioma had to be removed as well as the part of the frontal lobe that had been damaged by it.

After the operation, Elliott appeared normal in most ways. He could talk, walk and still had his knowledge base. Nevertheless, he could not hold a job as he had before the surgery. The problem appeared to be that he could not prioritize and stick to the task at hand. What had happened to cause this was not clear. The only hint that Damasio had to go on was that Elliott confided to him that he knew his feelings were changed from before the operation to after the procedure. Issues that had once caused an emotional reaction in him now made no impact at all, either positive or negative. It appeared this is why he was unable to make effective decisions for himself about how to best spend his time. He had no feeling that the decision affected him one way or another.

This observation sent Damasio into a series of experiments to investigate this problem scientifically: just how important is emotion when a decision is made? He honed in on testing risk taking because that is an important factor in most decisions. In his formal experiment, Damasio used a card playing game to assess the decision making process. He compared normal subjects to brain damaged patients with an injury in a specific area of the frontal lobe that deals with emotion called the ventromedial prefrontal cortex. This area links factual knowledge and bioregulatory states including emotions usually related to past individual experience. What Damasio discovered was both unexpected and dramatic.

People make better decisions when they use emotion than when they don't.

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The investigators clarified it this way, "In normal individuals non-conscious biases guide behavior before conscious knowledge does." This non-conscious bias is what people commonly call an intuition or a hunch. When we make losing decisions, we know it even before our intellect springs into action. Then, we have a chance to modify our behavior using this sixth sense. In other words, emotions have their place when we make monetary decisions. Without them, we can't and won't decide what is best for our economic future.

How can we use this research to our own benefit?

The best way we can use this knowledge to our advantage is to understand how our own emotions impact our investment decisions. Then, we can use our awareness, our sixth sense, to enhance feelings that will help us economically and diminish those that will do the reverse. This is what behavioral economics and neuroeconomics investigate. They give us understanding about our investment decisions so we can use that information to make future decisions more wisely. Knowledge of these areas goes a long way in securing a financially robust future.

The next excerpt from Physician Reach Radio will explore how emotion can undermine or enhance an investment decision.