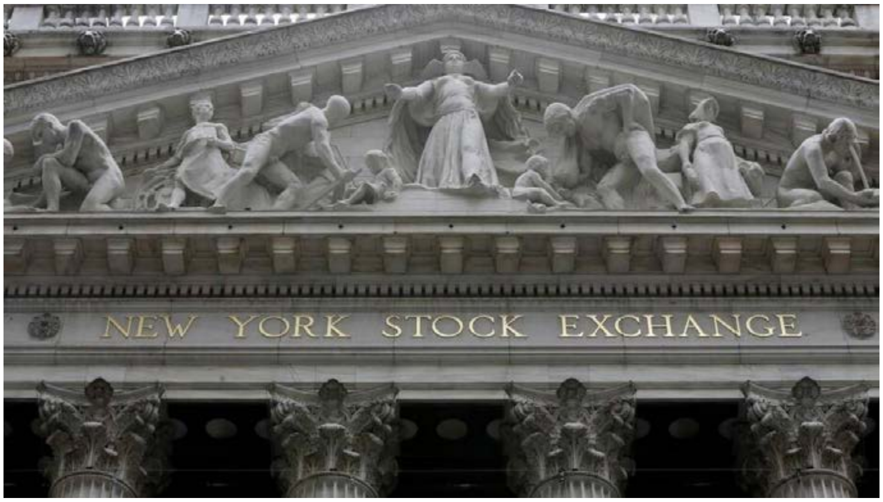

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For good money decisions, slow down

BY JONI LINDQUIST

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The human brain is amazing. Yet we still are learning about how it really works. In his book "Thinking, Fast and Slow," Daniel Kahneman outlines in simple terms how our complex brain works and in doing so gives us an understanding of how it can lead to sub-optimal decisions.

Kahneman explains two systems in the brain — System 1 is fast, intuitive and emotional while System 2 is slower, more deliberate and more logical. The fast brain makes connections in milliseconds, while the slow brain is used for more complex thinking. We see someone frown, our fast brain thinks they are sad. Our fast brain adds 1 plus 1 and comes up with 2. We need our slow brain (or a calculator) to determine the answer to 326 times 14.

This sounds good, right? The problem lies in that our slow system is also a bit lazy. This slow, deliberate system looks to confirm conclusions that the fast brain made. This is called confirmation bias – we look for data that supports our fast brain's quick conclusions and ignore contradictory information. It also leads to overconfidence in our decisions: We think we know more (because our fast brain is telling us so) than we actually do. Basically, our brain is a machine optimized for jumping to conclusions.

This affects decisions we make with money.

Our fast, emotional brain sees the markets going up and thinks it will always go up. We may get greedy and want to invest more at the very time the market is most risky. In a market downturn — which will happen again — our fast brain thinks the market will keep going down and we want to bail. Our intuition or fast brain creates panic.

Too often, people who are not following a financial plan let their fast brain control their decisions, with sub-optimal results. We sell when markets are low and buy when markets are high — a bad combo!

Likewise, our fast brain tells us that our job and income are secure and we'll continue to get good raises and annual bonuses. We start to spend ahead of these expected salary and bonuses. Then things don't go as planned. The raises and/or bonus don't occur and now we have a cash flow issue that may hurt our ability to save for longer-term goals. We let our fast brain drive our spending behavior.

Another area where our slow and fast systems conspire together to trip us up is "anchoring." Anchoring occurs when we put a value on something before estimating or getting the real number. It's why we're told never open negotiations with a price: It sets the anchor.

This can affect financial issues as well. For example, assume the company we work for provides part of our compensation in company stock. The company is doing great, we are emotionally tied to it and we hold the company stock even as we get more and more each year. The stock price when we receive it is in the range of $25 to $30 per share. It runs up to $60 per share. Things are great, until they aren't.

The stock that was once worth $60 tumbles, all the way down to $5. We've watched this and don't sell any shares, because $60 becomes our anchor and our fast and slow brains don't want to feel the pain of selling at a perceived "loss" from the high of $60. In the meantime, we've lost out on an opportunity to profit from the stock.

These are just a few examples how our brains are wired to work against us. What can we do to minimize bad money decisions?

1. Be aware that your fast brain jumps to conclusions based on intuition and emotion regarding your personal income, spending, savings, investing and tax planning.

2. Participate in an ongoing financial planning process based on your goals. Establish the blueprint with your slow brain in unemotional times and monitor it and make changes (with the slow brain in tow) as life happens and your goals change.

3. Tap into your slow brain consistently – don’t rush to make decisions!

4. Know that your slow brain will look for data that validates your fast brain. Working with a Certified Financial Planner can help by providing data and information to expand your thinking.

5. Recognize anchors that color your thinking. Test your thinking: What anchors or assumptions are you holding that affect your decisions?

6. When tough times hit – a job loss, a market downturn – know that your fast brain will jump to potentially harmful conclusions. Having an ongoing relationship with a financial partner can help you slow down and make good money decisions. We don’t know when tough times will hit, but it is valuable to have that financial coach when they do!

Our brains are wired to sub-optimize decision-making, particularly with emotional issues such as money. Slow down, expand your information gathering, and hire a competent partner to help push through your biases and you’ll likely improve your decisions!

Joni Lindquist, MBA, CFP®, is a Principal at KHC Wealth Management and a Certified Financial Planner™. She strives to help clients live the life they want by helping them identify their goals, create a plan and take action. Lindquist is an active member of the Financial Planning Association of Greater Kansas City.