8 Things I Learned From Your Money & Your Brain

> "The best investors make a habit of putting procedures in place, in advance, that help inhibit the hot reactions of the emotional brain." – Jason Zweig

Neuroeconomics is the study of how we make decisions using brain activity (neuroscience), economics and psychology. Think of it as the behavioral finance of our intuition and reactions.

In his book, *Your Money & Your Brain*, Jason Zweig goes through multiple studies and stories to show how our brains react to different forms of stimulus (mostly gains and losses). Here's what I learned from this excellent book:

1. The brain activity of a person that's making money on their investments is indistinguishable from a person who is high on cocaine or morphine. According to Zweig, the brain of a cocaine addict who is expecting to get a fix and people who are expecting to make a profitable financial gamble are virtually the same. This explains why we tend to get overconfident and greedy with our investments. We want more, more, more because of the rush.

2. Getting exactly what you planned for is basically a non-event for your brain activity. Seeing the fruits of your labor should be satisfying. It should motivate people to continue on the path that they are on. Unfortunately, it doesn't do much for our feelings if we are already planning on something. We need a bigger hit of adrenaline or dopamine to get a bigger fix every time for the same emotional response. This can cause us to increase our risk and use forms of speculation to get that response.

3. Losses and gains have profound physical effects on the body and brain. I'm sure everyone has seen the physical and mental toll that financial stress can have on a person. It's a euphoric feeling when we win money, even something as small as a scratch off lotto ticket. We can actually feel it. And losing produces a horrible feeling in the pit of our stomach that can linger for days on end. The stress from financial troubles can wear on a person's body and psyche.

4. Financial losses are processed in the same area of the brain that responds to mortal danger. And it is literally true that we can relive our financial losses in our sleep. This helps explain why losses hurt so much more than gains feel good. Loss aversion can be a huge problem for our long-term financial health if we let the mortal danger signal take over during a panic in the markets.

When the market crashes, stocks become cheaper and are a better deal for long-term investors. However, these feelings of panic make it tough for investors to buy stocks because of the after-effects. We've seen this play out since 2009 as stocks have made back their losses and then some, but stock ownership continues to decline.

5. The bigger the potential gain, the greedier you feel. This is regardless of how poor the odds of earning that gain might be. Our love of gambling and the hope of hitting it big by winning the lottery is an obvious byproduct of this greed. It's why people buy 10 Powerball tickets to "improve" their odds from 1 in 175 million (0.000000057%) to 10 in 175 million (0.000000571%). That faint possibility of a large gain trumps the miniscule mathematical probabilities of actually winning.

This also leads investors to invest in exciting growth stocks that are overvalued as the promise of never ending gains and growth clouds their judgment.

6. The anticipation of a gain evokes a much larger response than actually receiving the gain. In other words, **money doesn't buy happiness**. People tend to spend plenty of time planning to buy something expensive and feel the rush in anticipation of that purchase only to feel let down once they actually buy it. Retail therapy is fleeting.

The expectation of both good and bad events is more intense than actually experiencing them. Zweig sums this up nicely: "The anticipation of reward is more important for memory formation than is the receipt of reward."

7. Our brains automatically and unconsciously expect a 3rd repetition after we see two in a row of something. There were studies in *Your Money & Your Brain* that looked at the response of subjects trying to make predictions about unpredictable events. Even though the subjects were told ahead of time that what they were looking at was unpredictable, they still thought that they could do it, even if everyone else would fail.

Everyone loves to try to predict what will happen next in the financial markets or the economy. Most don't realize that as humans we are very poor at forecasting the future. Study after study proves this point. This is especially true for those that are the most sure of their forecast.

8. The happier you are, the longer and healthier your life will probably be-and the more money you are likely to have. Here's Zweig with some great insight on this subject:

In 1957, the average American earned about $10,000 (adjusted for inflation) and lived without a dishwasher, clothes dryer, TV, or air conditioner. But 35% of people surveyed then said they were "very happy" with their lives. By 2004, personal income had nearly tripled after inflation, yet 34% of the people now said they were "very happy."

It all comes down your perspective. Most people think they need more of everything (money, material possessions, etc.) to be happy, yet most claim that spending time with family and friends is what makes them the happiest.

THE TAKEAWAY

If you enjoyed *Thinking Fast and Slow* you will really like this book. Zweig covers many more interesting studies on your brain and the emotional responses that come from financial outcomes and decisions, but also gives practical advice on how to overcome these issues with real world examples and different scenarios.

It's a really thought-provoking book that's a must read for anyone that would like to understand their own actions better along with what is going on in the brains of other market participants.

Source:
Your **Money & Your Brain**

Further Reading:
Saving Investors from Themselves (WSJ)
Lessons **From Thinking Fast and Slow**