



A Farce Called Intuition

– by John Augenblick

In the 3rd grade I used to lean back in my chair precariously teetering on the two back legs. Not to worry though, I had a plan. If I felt myself tilting backward I would just quickly lean forward and right myself. Not only did I know what I was doing (I was in control), but I had good intuition about when the teacher might turn around. Clearly, I would never be caught and I would never fall backward to the floor. Right?

As you might imagine, I was scolded repeatedly and of course I fell numerous times until I corrected my behavior. Unfortunately, adult investors are not quite as diligent about correcting bad behavior, as they have no hard floor or irate teacher to hold them accountable. As a result, overconfidence and reliance upon intuition play very large roles in the systemic erosion of family portfolio values.

Coupled with the overconfidence issue, is the harsh reality that we are wired completely backwards for proper investment behavior. Stocks must be the only entity that we want to buy more of as prices go up, and get frustrated and sell when prices drop. Can you imagine yourself at a flea market where the guy selling knock-off sunglasses shows you a chart of the sunglass prices over the past six months? The price has marched steadily upwards from \$5 to \$15 to \$25 and now he is proudly offering them for \$40. You say to yourself, "Wow, these must be really great sunglasses...look how fast the price is moving up – I better buy 40 pairs before the price goes up even higher."

The premise sounds ridiculous with sunglasses, but substitute a trendy sounding stock like "Sugar to Ethanol Brazilian Biofuels, Inc." and all of a sudden there is that urge to scoop up stocks at \$40 per share because the price has risen higher and the stock *sounds* good. Why in the world do we always want to buy stocks *after* the price has gone up? Somehow we, the investing public, just can't conceptualize that historical price trends have no statistical relationship to future price movements. Instead, we love to see 5-star funds with upward sloping graphs just because some marketing pros are quick about thrusting them in our face every time an upward trend temporarily appears in some fund, some sector, or in some stock.

Let's stretch the Biofuel example a bit further. I'm certain you know someone who has convinced themselves to buy a stock with a litany of rationalizations similar to: "Biofuels are definitely the future. We're running out of oil - look how many more people in China and India are going to need oil over the next decade. Sugar to ethanol...that is brilliant – I bet most people don't even know that's possible. If oil goes to \$200 a barrel this stock is going to be golden. They just opened five new processing stations in Brazil and that economy is doubling every six years. The stock was listed on investopeida.com's five ethanol trades to make for September." <Insert other idiotic, wealth crippling rationalizations here.>

However, with perhaps slightly different perspective, what that misguided person is really saying is: "I know something the rest of the investing public does not. I know the market price of this stock is wrong, and it should be much higher. I have better intuition and a better understanding of the future cash flows of start-up Brazilian Biofuel companies than other investors. I will take control during this down market by trading my way to better returns. I am one of the very few individuals in control in the unknowable and uncontrollable markets and I will outmaneuver my way to economic bliss. I am smarter than others who participate in the global equities marketplace."

Think about the ego statement required to buy that stock. I'm certainly not advising anyone whether or not to buy start-up Brazilian Biofuel companies. I just want you to be cognizant that overconfidence, intuition, and a lemming-like pursuit of price trends will not help you, or anyone else, accomplish real financial goals. You are taking enormous strides toward patiently building wealth as you cast hubris aside. Do not succumb to the illusion of control that trading gives investors,

as you are comfortably positioned for the inevitable market recovery while everyone else will be scrambling to dump their Brazilian Biofuel stocks for half of what they paid.

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