

Mindless eating, mindless investing

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One of my favourite investment analysts is James Montier. Those who have had the privilege of hearing James talk will know why. He is funny, smart and straight talking, which is a good start.

But what I really like about him is that he hoovers up all the psychological research that I'd love to read if I had more time and condenses it into meaningful investment insights. I want to share with you his recent take on a book about mindless eating and the implications for investing – a book called *Mindless Eating* by Brian Wansink.

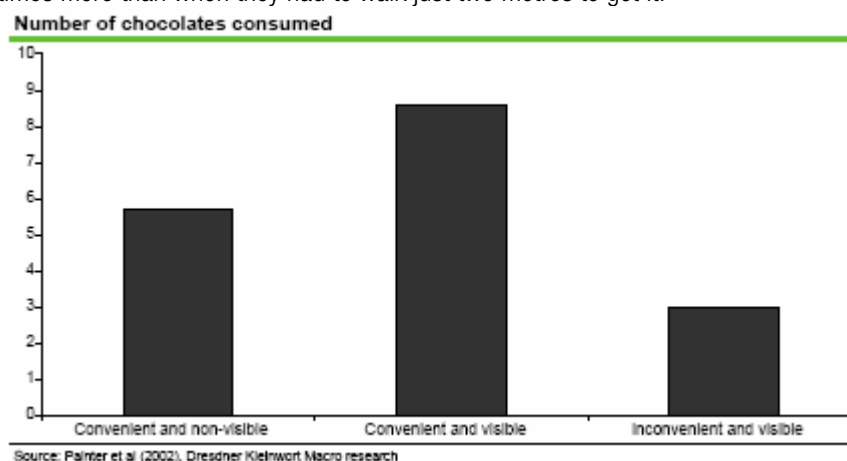
Now, you may ask - what does mindless eating have to do with investing? Well, the answer is quite a lot!

The starting point of behavioural finance is to recognise that our brain has evolved over 200,000 years to help us survive – not to succeed at investing. Similarly, as Wansink points out mindless eating has deep evolutionary roots:

“We are hardwired to love the taste of fat, salt and sugar. Fatty foods gave our ancestors the calorie reserves to weather food shortages. Salt helped them retain water and avoid dehydration. Sugar helped them distinguish sweet edible berries from sour poisonous ones.” In short, we have a brain and a physiology that is still largely designed for an environment that is very different to the one we live in today.

Hide the chocolate

A pervasive and dangerous bias in investing is our propensity to act on information that comes our way ('noise'), even if it is irrelevant. The evidence shows that the more frequently we look at our portfolio the more likely we are to trade. The more we trade the more likely we are to destroy value. Painter et al showed we have the same tendency with food. They placed bowls of chocolate all around an office. When the chocolate was on people's desk, where people could see it constantly, they ate on average three times more than when they had to walk just two metres to get it!

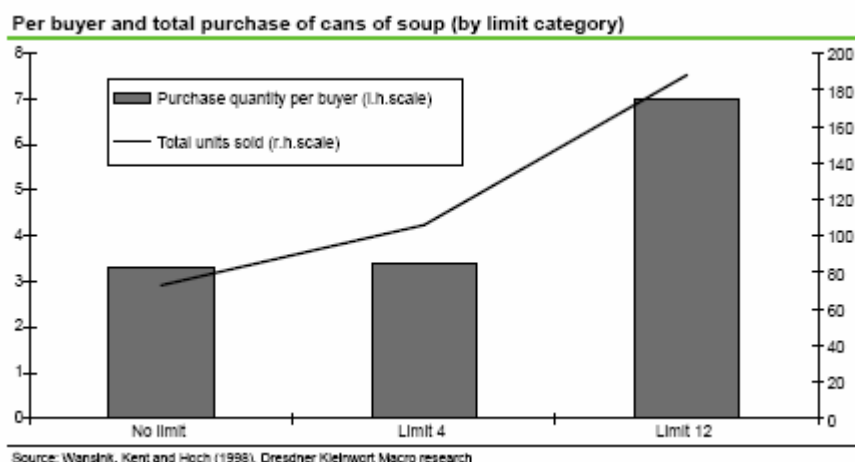


This highlights that we have less control of our response than we think and that controlling the information our brains receive is a necessary part of successful investing.

At this point I should probably write a timely warning -- beware that our bias to overconfidence makes us think that this message applies to everyone else but me!

Cans of soup

Our tendency to make decisions by 'anchoring' onto irrelevant data points is also a tendency that transcends investing and eating. Wansink tested how many cans of soup people would buy under three different scenarios – "No limits per person", "Limit of four cans per person", or "Limit of 12 cans per person". The graph below shows how strikingly consumption changed merely through changing the limit.

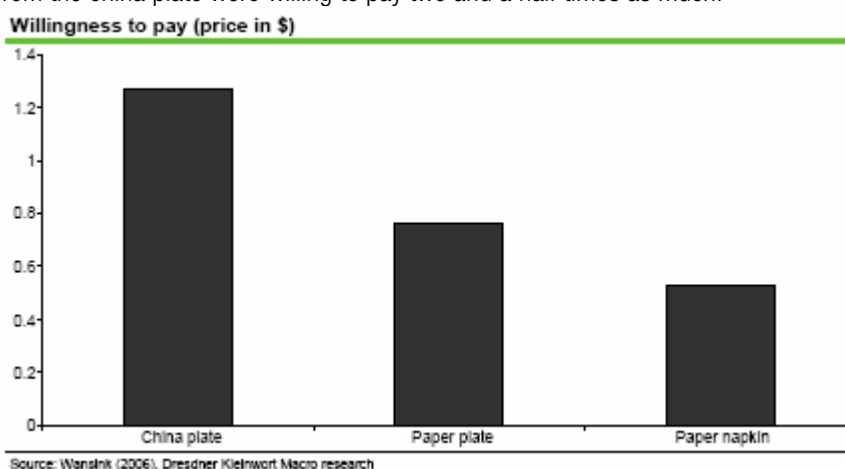


The higher the limit, the more cans were bought because brains anchored onto the irrelevant number. Another warning: beware the lure of the limit, whether shopping or considering capacity constrained investment strategies.

Brownies and hedge funds

Framing is also a key driver of behaviour. Most of us have probably noticed that the bigger the popcorn container, the more we tend to eat. A classic experiment involved giving 175 people in a café a free brownie. The brownie was the same size and from exactly the same recipe. The one difference was the way it was presented. Some received it on a china plate, some on a paper plate and some in a paper napkin.

Everyone was asked to rate the brownie and how much they would pay for it. Amazingly, people who ate from the china plate were willing to pay two and a half times as much!



This is a classic example of our susceptibility to framing. Shiny new wrappers in the investment sphere make us more likely to pay more. A number of tactical asset allocating trusts, many with a track-record of consistently destroying value through active asset allocation, reinvented themselves as 'global macro hedge funds'. A shiny new wrapper and suddenly many investors were willing to pay substantially more in fees for the same set of skills!

Beware good storytellers

In investing it is often true that the better the story the bigger the danger. Tech stocks are a classic, recent example. The same tendency exists with food. Wansink set up an experiment in a cafeteria where he asked people to rate food on quality, value for money and so on. Some days the food was labelled factually – "red beans with rice". Other days a more enticing description was added – "traditional Cajun red beans with wild rice".

With the descriptive (story) labels, sales rose nearly 30%; it seems telling stories around the Neanderthal campfire clearly runs deep in our psyche.

No safety in numbers

So if mindless eating worries us, what can we do? Well one solution might be to get together with friends. Unfortunately, the perils of group behaviour also impact our eating habits. Wansink found that when we eat with seven or more friends, we eat, on average, double what we eat on our own.

The only way to counter our hard wiring is to consciously create habits and rules that foil them. Control the food that enters your domain. Use framing to help, by using smaller plates.

The same principle applies in investing. To succeed, we need a codified set of investment beliefs that are justified by evidence and logic, and a disciplined process to implement them.

We also need to be careful about what information we look at. This means deciding in advance to screen out information that will not enhance decision making. For me it means re-reading the classics – Keynes, Buffett, and Ben Graham – people whose work has stood the test of time. It also means tuning into people like Montier who draw on different fields to bring genuinely new insights to the art of investing.