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# In The Media

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## Investors are Hardwired to Make Poor Decisions

Understanding of the mind's innerworkings can help us override impulsive behavior, consider logic and reason, and ultimately make better informed financial decisions.

— By Matthew Gaffey, CFP | June 3, 2021



John Maynard Keynes said, "It is the state of our own minds that matter the most." Just as the economy can sometimes behave erratically according to Keynesian economics, so too can the human brain (a phenomenon many of us know all too well). However, gaining a deeper understanding of the mind's innerworkings can help us override impulsive behavior, consider logic and reason, and ultimately make better informed financial decisions.

Behavioral financial advice is built upon a foundation rooted in neuroscience and psychology; emotional, cultural, and social factors. Behavioral financial advice essentially helps individuals manage both positive and negative emotions and improve decision-making under pressure. We've all experienced the differing outcomes of a decision based in facts and objectivity versus one that was driven by emotion—unfortunately, it can even amount to thousands of dollars of difference. In fact, decision making can have up to twice the impact on your overall performance than talent and skill combined.

To get to the root of how we make decisions, we need to take a deeper look at the brain and how it functions on a basic level. The act of making decisions occurs in three distinct parts of your brain: the amygdala, the prefrontal cortex, and the basal ganglia.

### **The Amygdala: The "Heart" of the Brain**

The amygdala is the "emotion" center of your brain. When faced with making a decision, it is the part of your brain that receives the signal the quickest, which is the reason individuals first respond to situations emotionally rather than cognitively. An emotional response takes 12 milliseconds, while a cognitive response requires 40. This hardwired "fight or flight" response can be advantageous when you are deciding whether you should run from a bear or lunge at it, but can be difficult to manage when making decisions around items that require more concentrated thought and prudence, like whether to run from or lunge at a bear market.

### **The Prefrontal Cortex: The Brains behind the Operation**

The prefrontal cortex helps you orchestrate your thoughts and actions. It aides in comparing contrasting thoughts, determining what is “good” or “bad,” and predicting potential consequences or positive outcomes of your actions. While this part of your brain is critical to cognitively challenging decisions or situations you find yourself in, it responds less quickly than the amygdala. In other words, the amygdala is like the text message you shoot off without a second thought, and the prefrontal cortex is the email to your boss you reread over and over again before hitting send.

Ultimately, your prefrontal cortex enables you to align your thoughts and actions with your goals. The catch is that you must allow your brain the time to process the information available to make the prudent decision. Often, this can be one of the biggest differences between the emotional investor and the disciplined investor. The emotional (and typically less successful) investor reacts, while the disciplined (and typically more successful) investor responds.

### **The Basal Ganglia: Your Autopilot**

The basal ganglia are the “habit” centers of your brain. This is the part of your brain that helps you streamline your decision making and actions, efficiently processing information. For example, when you brush your teeth, you’re not required to expend any mental energy on how to accomplish the task; you simply do it. You can also thank your basal ganglia when you drive to a new restaurant or coffee shop and mistakenly take the wrong turn at an intersection because it is part of your normal route to work.

While it can be helpful for the basal ganglia to create these shortcuts to ease the load on the amount of information we process daily, the effects aren’t all positive. Sometimes we are prone to making the same bad decisions over and over again because of habit (think reaching for that second donut because it’s part of your morning routine). However, by consistently making decisions that are aligned with your goals, you can reinforce or create new positive habitual impacts.

The brain is a complex machine. According to researchers at Cornell University, we make 226.7 decisions each day on just food alone. It’s also estimated that the average adult makes approximately 35,000 remotely conscious decisions daily. Learning more about the different components and functions of the brain can give you insight into your own habits and actions—and that is the first step to making better decisions.

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