First Quarter 2019

Is Intuition a Liability or Asset in Investing?

One emotion the rollercoaster financial markets of the fourth quarter produced in excess was gut reactions to the uncertainty of future market direction. Was it time to take cover or look for buying opportunities? Were stocks over-valued or over-sold? Depending on one's viewpoint, there were plenty of news articles and analyst opinions to support any conclusion an investor might want to reach. The right answer and the best reactions to the turmoil of the quarter will be known only through hindsight.

But it does bring up a very important question. Can investors trust their gut reactions or intuition in times of uncertainty? The answer is … it depends.

It helps to understand what is and isn't intuition. Intuition is typically defined as *knowing without knowing how you know.* Daniel Kahneman, a Nobel Memorial Prize-winning behavioral economist, takes a bit different approach to intuition defining it as *"thinking that you know without knowing why you do."* In Kahneman's definition is the reality that intuition is not always correct.

Intuition can be a very beneficial shortcut to making decisions when a person is under stress or doesn't have much time to think through all the implications of what is happening, particularly when facing complex problems. In situations where there is a large amount of information involved that swamps our ability to process quickly, intuition often results in the right answer for the moment.

But…and there is always a but, intuition works best when we are dealing with a decision where we have past knowledge. An intuitive decision is more likely to be correct when you've had considerable experience in making a certain judgment – i.e. evaluating and selecting investments. It also helps, according to Kahnman, when there is some regularity in the world that someone can pick up and learn, providing a subconscious knowledge or background that can be tapped by an intuitive decision. Then one needs to have a lot of practice making intuitive judgments and almost immediately knowing whether or not one's intuition is right or wrong. Immediate feedback hones future intuition.

Fear can masquerade as intuition. When we are fearful, we are more likely to make rash decisions or believe that we are following our intuition because of the fear-enhanced strength of our mental voice. Cultural surroundings, prejudices and emotions can adversely influence intuition.

To make intuition as asset rather than a liability in investing, it helps to take a moment and slow down.

- Write down what you intuitively feel is the right action.
- List your fears surrounding the decision. Making your fears visible will help you to determine whether the action you are considering is driven by fear or clear knowing.
- Ask yourself if you have experience in making similar decisions in the past. The more experience you have had in the same issue, the more likely your intuition is providing the right decision.
- If you have time, move the decision to the "back burner," and let the thought bubble in your subconscious. This can allow you to relax, consider new perspectives and open yourself more to your intuitive knowing.
- Realize the intuition is never the only solution. Provided we have time, there are situations where conscious reasoning is a better tool for making decisions.

Intuition is real. There are far too many instances in life where making an instantaneous, intuitive decision has saved lives and changed the course of history. But there have also been intuitive decisions that have turned out very badly.

When it comes to investing, a rules-based approach to quick decisions typically outperforms "gut" reactions. These rules are the underlying basics of active investment management.

While past performance is not an indication of future returns, history and markets tend follow patterns and cycles. A risk-managed approach to investing looks at when those past patterns have been favorable for investing and designs rules to support investing in strong markets and retreating to more conservative positions when similar market conditions have been negative for investors in the past. While no investment strategy is without risk, having a plan and rules to follow relieves investors of the need to worry about the right strategy for the moment and lessens dependence on gut reactions or fear responses.

Brian Carruthers

Brian R. Carruthers, CFP, CMT

BCA
BRIAN CARRUTHERS & ASSOCIATES

Your Conservative Advisory Firm Since 1990
301 Forest Avenue
Laguna Beach, California 92651-2115 USA
Telephone: 1-949-464-1900
www.gobcafunds.com
brian@gobcafunds.com