

## Beam Me Up Scotty, Vulcans Have Taken Over Planet Finance

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Can you out-geek me? **In just the last month, I saw the latest Star Trek movie, not once, but twice.**

The first time, I took my eldest son ("Thing 1"). The second, I dragged along his younger brother ("Thing 2"). And while in public I hid behind the explanation of, "I need to go again in fairness to Thing 2 who couldn't make it last week," **the truth is, it was my 30+ years of Trekkiedom**

**that had me aching for a second showing.** (And by the way, before you sic social services on me, I mean "Thing 1" and "Thing 2" as in [The Cat in the Hat](#), not as in I didn't get around to naming my kids.)

If you are not a Trekkie, feel free to indulge in a moment of smug superiority at my pathetic need for subterfuge to justify seeing the movie again. But what can I say? It was 2 hours and 6 minutes of immensely satisfying, visually stunning, action-packed drama.

**It was during the second showing that I had an epiphany about the popularity of the Spock character.** As you probably know, Spock struggles with an oddly compelling identity issue: He's the son of a human mother and a vulcan father.

As you are also probably aware, vulcans are ubernerds - humorless and boring in their slavish devotion to logic. Humans, of course, are quite the opposite. And so for Spock, much of the drama - and much of the reason, I believe, behind why he's become such a cultural icon - is found in his own internal tug-of-war, as he works to keep his human half under control.



**As a species, it seems, we humans have a deep distrust of our emotional selves;** it's the part that gets us in trouble and that makes us do things we later regret. And so as the sub-species known as "Investment Professional," we take a different approach - we behave as shameless vulcan wanna-bes.

**But it's a façade - an act performed for our clients and for ourselves, in the hope that by removing emotion from investment decisions, they'll somehow be more accurate.**

Ridiculous. No matter with how much math, accounting and economics we dress up investing, all of us professional investors are financial versions of Madame Zelda, the fortune teller. **We have to be - our investment decisions are based on our *predictions of the future.***

We predict what stocks are going to go up, based on plodding trend extrapolation about inflation, interest rates, the economy, the global geopolitical climate, the weather, and whatever else we can think of. The numbers are there to make our predictions seem more like science, and less like emotion-tinged guesswork.

As a newbie financial analyst, my first introduction to this mindset was a mutual fund infomercial, where the portfolio manager ripped an annual report in half, saying something along the lines of, "I throw out the front half - never mind the pictures or what management says - I just invest on the numbers." That way of thinking is everywhere. **If you analyze marketing materials from investment firms you'd think vulcans had taken over *all of Planet Finance, with all the talk of scientific-this, and emotion-free that.***

It's a mistake. I didn't get it then and I don't get it now.

**First of all, numbers are no more trustworthy than words.** Financial statements are imperfect representations of the complexities they describe. There's a lot of subjective interpretation in accounting, and a con is just as easily perpetuated in numbers as in fast-talking words.

**Second, scientific evidence suggests that feelings are required for making good decisions** (indeed, the movie reveals that vulcans do have feelings and deeply felt ones at that). Take [this recent New York Times article](#) which describes how soldiers' hunches save lives, and how the army is studying those hunches to make better soldiers:



"Not long ago people thought of emotions as old stuff, as just feelings - feelings that had little to do with rational decision making, or that got in the way of it,' said Dr. Antonio Damasio, director of the Brain and Creativity Institute at the University of Southern California. 'Now that position has reversed. We understand emotions as practical action programs that work to solve a problem, often before we're conscious of it. These processes are at work continually, in pilots, leaders of expeditions, parents, all of us.'"

A well known study by the same Dr. Damasio shows that good decision making doesn't have to be conscious. In this study, volunteers bet on cards drawn from different decks. Some decks were much better than others, and participants caught on to this fast. They "liked" these decks, although they could never explain why. Meanwhile, their bodies telegraphed via tension (and sweat) which decks to avoid. The emotional, human brain recognized the dangerous decks, but the logical, Spockian brain, did not.

**In fact, while our emotional brain may lead us astray sometimes, an emotion-free brain simply can not make good decisions.** Patients who have brain damage so that they have all their analytical and rational skills at hand, but suffer from an inability to feel emotions, consistently make stupefyingly bad decisions. They lack the overlay of good judgment that comes from prior experience and that makes us "feel" a bad decision. This "hunchy" part of the brain is needed - a strictly by-the-numbers analysis is not sufficient.

So, if this is the case, **why then do we perpetuate the charade that our investment analysis is emotion-free**, that our precise and arithmetically correct calculations make no guesses about the future, and that valuation is never subject to psychology? After all, while prices may be set using mathematical frameworks, the people *paying* the prices are more Captain Kirk than Spock.

Case in point: [Prior to 1958](#), investors always needed to have stocks yielding more than bonds because they thought stocks were weapons of wealth-destruction. **For decades the stock market was deemed cheap or expensive based on how narrow or wide the spread was between dividend yields and bond yields**, and stock yields never dipped below bond yields. Until one day that relationship broke down, and when it did, it did so for good.

Why? The zeitgeist had changed. People valued the potential returns of stocks more than their risks relative to bonds. If you waited for reversion to the mean you'd still be waiting today. In the end, all the calculations in the world couldn't trump a change in psychology.



In order to "Live Long and Prosper," we need to admit to ourselves - and to our clients - that **precise analytical calculations are no substitute for good human judgment; the kind of good judgment that is grounded in all parts of our neurochemistry.** I have a hunch that even Mr. Spock would agree with that.

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