Quarterly Point of View
Finance of 'The Shallows'

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Leading up to last year's presidential election, the famed political commentator Peggy Noonan wrote in *The Wall Street Journal*:

> *The 24/7 news cycle and the million multiplying platforms with their escalating demands – for pictures, videos, sound, the immediate hot cake – exhaust politicians and staff, and media people too. Everyone is tired, and chronically tired people live on the Edge of Stupid. More important, modern media realities make everything intellectually thinner, shallower… This year I am seeing something, especially among the young of politics and journalism. They have received most of what they know about political history through screens. They are college graduates, they're in their 20s or 30s, they're bright and ambitious, but they have seen the movie and not read the book. They've heard the sound bite but not read the speech. Their understanding of history, even recent history, is superficial. They grew up in the internet age and have filled their brainspace with information that came in the form of pictures and sounds. They learned through sensation, not through books, which demand something deeper from your brain. Reading forces you to imagine, question, ponder, reflect.*

In reading her piece I remember thinking - this sounds a lot like the 'pop-finance' investing culture that seems to be developing as well. Noonan referenced *The Shallows, What the Internet Is Doing To Our Brains*, a New York Times Best Seller by author Nicholas Carr, about the internet's effects on the way we think. After reading the book myself, it is clear we have a lot we need to 'be aware of' as it pertains to the way we consume and utilize information in making investment and financial decisions.

Carr's book posits that modern channels of information supply not only the "stuff of thought," but they also shape the "process of thought," at the same time degrading our "capacity for concentration and contemplation." As websites routinely collect detailed data on user behavior, statistics tell an incredible story of how hastily we leap between thoughts online. A specific study by a firm called ClickTale was cited, in which they determined in most countries users spent, on average, between 19 and 27 seconds looking at a webpage before moving on, and that includes the time it took for the page to load into their browser's window. Carr states:

> *The information flowing into our working memory at any given moment is called our "cognitive load." When the load exceeds our mind's ability to store and process the information – when the water overflows the thimble – we're unable to retain the information or to draw connections with the information already stored in our long-term memory. We can't translate the new information into schemas. Our ability to learn suffers, and our understanding remains shallow…*

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Why is this important? The biggest risk investors face is not the direction of interest rates, the next decision by the Federal Reserve, or the action of their least favorite political party. The biggest risk to investors is the self-inflicted kind – an emotional or cognitive bias, and its destructive consequences. If we give even a morsel of truth to the premise of *The Shallows*, primarily that we have a thin, even superficial understanding of most topics, then we need to understand that the way information is consumed could very well exacerbate these biases, impacting long-term financial health.

The study of behavioral finance analyzes the effects of social, cognitive, and emotional factors on the economic decisions of individuals and institutions and their consequent impact. Primarily concerned with investor rationality (or lack thereof), this analysis typically integrates psychology and sociology with microeconomic theory to identify mistakes investors make in reasoning or evaluation. Given that investors are getting most of what they know about finance and markets through the internet and social media - and grabbing it without much more than a 27 second and 140-character attention span - there are a few primary behavioral risks that should be considered.

Availability bias

Evidence suggests that recently observed or experienced events strongly influence decisions. For example, researchers have found that individuals were likely to overestimate the chances of being in a car crash if they had seen a wreck on a recent road trip. The recent memory made the prospect more vivid and retrievable in their mind - and therefore more likely. In a similar fashion, when asked to recall a list of items in any order, people are inclined to begin recall with the end of the list, as those are the most striking in memory. For investors this risk is acute, in that important buy and sell decisions might be made simply because they recall (often subconsciously) recent stories or tweets with this bias. Similarly, investors are more likely to be fearful of a bear market when one has occurred in the recent past, or conversely, apt to believe a bull market will keep rising the longer that trend registers 'availability' in memory recall. From multiple angles, this bias can be harmful unless addressed in decision-making.

Representative bias

With this heuristic, decisions are made based on a situation's superficial characteristic, or in other words, a judgmental shortcut. A common example might be someone who says, "I love that company's products, and I hear about them everywhere, so I know it will be a good investment." The idea sounds reasonable, and it's used constantly, but it fails to consider many other factors. When investors rely on this method to make judgments, they are often failing to separate the fact that representativeness does not equate to the probability of a certain outcome.

Confirmation bias

This is the tendency to seek, interpret, recall and favor information in a way that confirms our preexisting opinions. Because of the way nifty algorithms work on the internet, we all tend to get 'more' of what we already seek the most, which certainly doesn't help dispel this bias. We also follow individuals or groups of our own choosing on Twitter, Facebook, Instagram etc. and we likely have selected them in the first place because we share common bonds and viewpoints. These groups have the capability to exert enormous influence on our decision-making as they confirm what we 'want' to know.

Groupthink / Conformity bias

Groupthink has been a well-documented bias for ages, a phenomenon that occurs with groups of people in which a desire for conformity overrides rational decision-making. In an attempt to minimize conflict and reach consensus, conclusions are often formulated without critical evaluation, and dissenting or alternative viewpoints are dismissed. Individual creativity is inadvertently lost, and as the group begins to 'agree,' a dysfunctional dynamic of overconfidence develops. It is likely that through history, many of the world's wars have been fought after this bias developed within a decision-making group. Additionally, many of the investment world's greatest asset bubbles have also ballooned as a result - think Dutch Tulips in the 1600's, Japanese Real Estate in the 1980's, or U.S. Housing in the 2000's. It is not required to have groups 'physically' present for this bias to occur.

The internet is an astonishingly rich tool, offering access to almost unlimited information on virtually any topic, delivered at warp speed. But the way information is constantly presented to us, and the way we consume it, may regrettably condition us to the cognitive biases discussed above, amongst others. To be observant of this, and to develop mental 'work arounds' to limit negative effects in decision-making, is a worthy aim for investors. As Peggy Noonan described earlier, the internet and media platforms 'exhaust,' and chronically tired people live on the 'edge of stupid.' Warren Buffett's business partner, Charlie Munger, has stated much of the long-term advantage they have realized has come from "trying to be - not stupid," and further saying a lot of people "try to be brilliant, and we are just trying to stay rational." As is often said, investing is a marathon not a sprint, and over the long haul 'not stupid' and 'rational' count.

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It is a sincere privilege serving those that have entrusted us with their capital.

Respectfully,

Cameron K Martin
Chief Investment Officer
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1. The Wall Street Journal 10/1/16
2. The Shallows, What The Internet Is Doing To Our Brains. 2011. Nicholas Carr

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