

How to Be a Better Investor

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The essential books for any investor include classics such as Burton Malkiel's *A Random Walk Down Wall Street*, Benjamin Graham's *The Intelligent Investor* and Peter Lynch's *One Up on Wall Street*. To this library, I would add a volume that never even uses the word investing. It's *The Organized Mind*, by Daniel Levitin, a professor of psychology and behavioral neuroscience at McGill University. In his just-published book, Levitin shows how understanding the way our brains work can help us make better decisions.

Nobel Prize winners Daniel Kahneman and Robert Shiller have applied behavioral-economic insights to concepts such as market bubbles and our aversion to losses. Their research shows that during bubbles we become convinced that some greater fool will always pay more for what we've bought. It also shows that we irrationally tend to hang on to individual investments longer than we should in order to "get even." The actual picking of stocks, however, seems to be beneath the dignity of most academics.

That's too bad. Knowledge of the brain gleaned from research over the past few decades can truly make you a better investor--and by that I mean not just a better asset allocator but also a better chooser of stocks and mutual funds. Here are the lessons I've learned from Levitin and the other brainiacs.

Give it a rest. The most powerful investment analyst is right between your ears, so begin by treating your brain well. The best way to do that is by getting plenty of sleep and physical exercise and by not multitasking.

Your brain performs important processing functions while you sleep, so you need to give it the time it needs to digest and analyze what it has learned during the day. "A night of sleep," writes Levitin, "more than doubles the likelihood that you'll solve a problem requiring insight." You may think you can perform two brain-dependent tasks at once (say, texting a friend and listening to colleagues on a conference call). But, in fact, you are switching back and forth between paying attention to one and then the other. That means not only are you failing to absorb either, you're also exhausting your brain in the long run.

Pay attention. To do your best work, you need to be free from distractions. The brain has a filter that operates in your subconscious, allowing you to block out random thoughts and focus on the job at hand. But that attentional filter, as it's called, can't overcome the blare of a television or the steady stream of e-mail competing for your attention. When you research a stock, set aside significant time--say, an hour--to read analyst reports and search the Internet. A stock decision could be worth hundreds of thousands of dollars in the long run; an hour is a reasonable investment.

Take your time. Kahneman shows how the brain operates on two speeds: fast and slow. The fast part involves intuition or emotion. We make quick decisions about people, things and ideas. The slow part follows up, often to support our initial impressions or justify our prejudices.

In making decisions about buying and selling stocks, you may tell yourself that you're not swayed by the passions of the crowd, but people really have a tough time resisting the views of the investing hordes. When you see others selling shares of Apple (**AAPL**) or buying Alibaba (**BABA**), you get the panicky feeling that you should, too. (Stocks in boldface are those I like.) Then you find facts and analysis to reinforce your feeling. For example, the new iPhone has problems, or Alibaba will sweep the U.S. online commerce market in a few years.

That's a dangerous way to invest. I combat the urge this way: First, when I feel a passion to buy or sell a stock or fund, I automatically question my impulse and test whether the opposite position isn't better. And, second, I take at least a week to execute a trade, even one I feel strongly about.

Externalize information. We should use our minds for their most important functions: synthesizing complex ideas, finding connections, imagining, summarizing, and projecting the future. Those are the very activities that are important for success in investing. However, too many of us clutter our brains with facts that clog up the works. Levitin suggests that we "externalize" as much as we can: Take the information out of our brains, and put it on paper or into our computers.

Here's an example. I like to make lists--on paper!--of stocks that may be too expensive right now but that I would like to buy if their prices drop. Currently, the list includes Adobe Systems ([ADBE](#)), American Express ([AXP](#)), Johnson & Johnson ([JNJ](#)) and Walt Disney ([DIS](#)). I check the list once a month to see if those stocks have come into my buying range.

Daydream. Our brain operates in two highly valuable modes. The first is attention, when we focus tightly on a problem. The second is daydreaming, which Levitin defines as the "distinctive and special brain state [that] is marked by the flow of connections among disparate ideas and thoughts, and a relative lack of barriers between senses and concepts."

Daydreaming (and dreaming when we're asleep) improves our creativity and our ability to solve problems. "James Watson uncovered the structure of DNA, and Elias Howe the sewing machine, in their dreams," writes Levitin. Mozart, Einstein, Wordsworth and practically every other genius related instances in which daydreams led to great conceptual breakthroughs. It's the same for stocks. Do the research, then let it percolate--for weeks even, turning the idea over in the shower or on your drive to work. Suddenly, an idea will crystallize. That is how I made my best stock decision ever: buying Netflix ([NFLX](#)) at \$22 a share in 2003 and selling it in 2010 at about \$180. (Yes, I know it's now over \$400!)

Get physical. When I first started to write about stocks in the mid 1980s, I would walk over to the offices of the Securities and Exchange Commission, in Washington, D.C., and take the elevator to a room filled with folders for thousands of publicly traded companies. The folders contained 10-K annual reports, 10-Q quarterly reports and other filings. Frequently, when I was looking for data on one company, the files of another company would catch my eye, and I would find a great investment idea.

This kind of "browsing and serendipity," as Levitin calls it, rarely happens when you conduct your research electronically. He quotes Nicholas Carr: "A book focuses our concentration, isolates us from the many distractions that fill our everyday lives. A networked computer does the opposite." For example, I much prefer the *Value Line Investment Survey* in its original, loose-leaf binder format than its online version. In a binder, as I search for ExxonMobil ([XOM](#)), I may run across General Dynamics ([GD](#)), a stock I haven't looked at in years, and find a good buy.

Reading a book or printed research isn't the only physical experience that makes you a better investor. As Peter Lynch emphasized, observing the world around you--and noticing, say, crowds of shoppers at a new clothing chain store at the mall or an efficient new drill at your dentist's office--provides more facts for analysis or, as Levitin would have it, more fodder for your daydreams, allowing your healthy brain to identify great investments.

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