



When Emotions Take Over

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Introduction

This report is going to be a little bit of a psychology lesson. We are going into a discussion of the 'fight or flight' part of the brain.....what it is, how we have used it in the past, how it can get us into trouble both in our personal lives and in our investing, and how we can modify our behavior for better results.

What is the Amygdala

The amygdala is part of the limbic system, which regulates emotional and behavioral responses.

An amygdala **hijack** is a fight-or-flight response to stress.

To better understand what an amygdala hijack is, that involves two specific parts of the brain.....the amygdala and the frontal lobes.

The amygdalae are clusters of almond-shaped cells located in the brain's base. Everyone has two in each hemisphere. They define and regulate emotions, store memories, and attach those memories to specific emotions.

The amygdala also activates the fight-or-flight response. This response can help people in immediate physical danger to react quickly for their safety and security. For example, the fight-or-flight response helped early humans respond to threats to avoid injury or death.

The amygdala activates this fight-or-flight response without any initiative. In other words, it's instinctive. When that part of your brain senses danger, it signals your brain to pump stress hormones, preparing your body to either fight for survival or to flee to safety.

Today, that fight-or-flight response is more likely to be triggered by emotions such as stress, fear, anxiety, aggression, and anger.

So how does this relate to the frontal lobes?

The frontal lobes are the area of the brain that regulate voluntary actions like reasoning, thinking, movement, decision-making, and planning. And it is more rational than the amygdala.

The frontal lobes allow you to evaluate your emotions and then use your experiences and judgement to consciously respond. These reactions are not automatic, like the ones generated by the amygdala.

In the event of a physical threat, the amygdala may jump to the fight-or-flight response, but the front lobes process the information you're receiving to help you determine if the danger is real. If the danger isn't immediate, the frontal lobes help you decide what to do in response to the stress.

For mild or moderate threats, the frontal lobes can often override your amygdala so you can approach the situation rationally. But in the case of strong threats, the amygdala may trigger the fight-or-flight response.

For early humans, the fight-or-flight response was vital because the threat of physical harm was very real. Today, however, you're more likely to experience psychological threats. Anger, aggression, fear, and stress are all common emotional triggers. And they can cause sudden, illogical, and even irrational reactions.

In his 1995 book "Emotional Intelligence: Why It Can Matter More Than IQ," psychologist Daniel Goleman named this emotional overreaction to stress "amygdala hijack." The amygdala hijack occurs when your amygdala responds to stress and disables your frontal lobes. That activates the fight-or-flight response and actually disables rational, reasoned responses.

Symptoms of an Amygdala hijack

The symptoms of an amygdala hijack are caused by the body's chemical response to stress so your brain releases two kinds of stress hormones: cortisol and adrenaline. These are released to prepare your body to fight or to flee.

Together, these stress hormones.....

- increase blood flow to muscles, so you have more strength and speed to fight or flee
- expand your airways so you can take in and use more oxygen
- increase blood sugar to provide you immediate energy
- dilate pupils to improve your vision for faster responses

Some of the symptoms you may experience from this are:

- rapid heartbeat
- sweaty palms
- clammy skin
- And goosebumps on the surface of your skin.

But, an amygdala hijack may lead to irrational behavior.

How to stop an Amygdala hijack

Psychologist Goleman popularized the concept of emotional intelligence, or EI. He explained how EI can help people manage their emotions and guide their behavior and thinking. Where amygdala hijack is natural and immediate, EI can help you regain control.

Because an amygdala hijack is an automatic response, your body takes action without any conscious input from you. That does not mean you will be unable to stop or prevent an amygdala hijack. It just takes a conscious effort to deactivate your amygdala and activate your frontal lobes, which is the part of your brain responsible for rational, logical thinking.

When you feel threatened or significantly stressed, acknowledge how your body feels, and take stock of your emotions and physical symptoms. When you have calmed down or feel less stressed, you can activate your frontal cortex. Breathing can be a powerful tool to accomplish this so think about the speed of your breath, and work to slow it down. To change behavior, begin by thinking about what activated the response, and how you felt. Then, consider responses you can and should have. These will be more thoughtful and rational responses. When you first try this, this evaluation may have to occur after an episode. But when you feel this response again, acknowledge it, and work to regain control. When you recognize warning signs and triggers, you may be able to more easily handle the stress that leads to the response in the first place.

How to prevent an Amygdala hijack

The best way to prevent an amygdala hijack is to understand what things trigger the reaction so you can avoid them.

Emotional, mental, and even physical stress can trigger the amygdala's fight-or-flight response. When you begin to feel the symptoms of an amygdala hijack, pause and take note of what you're feeling and what led you to this moment. Recognize any bodily changes you're experiencing. Also, consider what triggered these feelings, like stress, anger, aggression. These are the beginning steps of responding in a peaceful way.

THERE ARE TWO TECHNIQUES TO STOP AN AMYGDALA HIJACK

- 1) **Reasoning.** Once you have calmed your emotional response, you can use reasoning and logic to think through your situation. This way, you have options for how you will respond, and you can pick the one that best suits the situation, not one that fulfills an emotional reaction.

- 2) **Mindfulness.** Use meditation or controlled breathing to focus your body's energy. This will help you respond to a threat or stress in a peaceful way. It will help you stop an amygdala hijack so you can retain control.

While you may find other ways to prevent an amygdala hijack, these two are the primary ways. Learning to avoid triggers can stop your amygdala from having a chance to overrule your emotional control.

How to apply this to finance

Imagine this... someone blindfolds you. They take you somewhere completely unknown. You get to your destination, and they ask you to stand still. They remove your blindfold – you look down and you're looking down at the glass floor from the observation deck of the Willis Tower 1, which is 353 ft about the city streets of Chicago! If you're like 99.9% of people you'll likely experience a rush of adrenaline and quickly jump back in fear for your safety. This is because of the amygdala part of your brain. Even though it can serve many useful purposes, it can also send false positives.

In the example I just gave, if the blindfold was kept on, you were standing on firm ground, there would have been no perceived risk and you would have never experienced this response. Because see, you never really were at risk. It was a perceived risk. And the same can often be true with investing...

How can this occur in investing? Well, a great example is negative headlines that can be perceived as a threat to your wealth and well-being.

"Corona Virus Spreading"

"If So and So gets Elected the Market will Go Down 20%"

"Recession Looming"

See, the body's "flight mechanism" is wired to spur you to take action now so you think....."I'm going to lose money, so I had better sell before it goes down!" The Dalbar study seemingly proves the average investor simply **cannot overcome** that innate response. Biology trumps logic - at least initially.

But successful investors tend to NOT think of investing in terms of absolutes or "I might lose some money over the next few months so I better not invest." Instead, successful investors take a long-term view based on logic - not emotion. They understand over the long run, they are investing in viable, sustainable companies with the ability to compound cash flow over time.

How can investors keep on track

With the endless stream of headlines in the news, client Amygdalas are firing on all cylinders. So how **can** you keep yourself on track and avoid value-destroying behavior?

1. **Awareness:** Studies like the Dalbar prove that knee-jerk, emotional responses usually destroy value. Historically equities return about 10% per year, according to Bloomberg. The market can favor investors long term; however, human brains are wired to lose.
2. **Emotional management:** Our brains are wired to avoid pain and to seek pleasure. These natural instincts are powerful. But while they were extremely useful when we were hunter gatherers, these same instincts can be very troublesome when making financial decisions. So, how do we surpass these survival instincts that have been hardwired into our brains? By using some of the techniques I described earlier like.....Reasoning and Mindfulness. These techniques allow you take slow down, breathe and relax, so you can allow the reasoning part of your brain to take back over.

The 6 Biggest Mistakes Investors Make

Mistake#1 is....Seeking confirmation of your own beliefs.

Your brain is wired to seek and believe information that validates your existing beliefs. We love confirmation of how smart we are. And this is magnified by the online echo chambers. News media tend to favor one point of view. Google filters our search results and unsubstantiated rumors can run unchecked. So, convincing yourself that a particular stock or strategy is correct without taking into account contradicting evidence, can be the nail in the coffin of financial freedom.

The Solution. Instead of going with your hard-wired response, stop and allow the reasoning part of your brain to take over. You do this by welcoming opinions that contradict your own. The best investors know they are vulnerable to confirmation bias, so they actively ask questions and seek qualified opinion that disagree with their own.

Mistake#2 is Conflating recent events with ongoing trends.

This simply means that you believe that the current trend of the day will continue, when you allow recent events to carry more weight than history.

The solution of avoiding this impulsive decision making is to commit to a portfolio allocation in advance and then rebalance on a regular basis. Another option is to commit to a particular style of asset management and stick with it. Buy and hold works well if retirement is off in the distance. But you may want to consider other options if retirement is close.

Mistake #3 is Overconfidence. This happens when we overestimate our investing abilities, knowledge and future prospects just because we are good at other areas of our lives.

The solution is to get and honest, and to admit that you have no special advantage so that you don't delude yourself in thinking you can outperform.

Howard Marks says...."If you can't predict the future the most important thing is to admit it. If it's trye that you can't make forecasts yet you try anyway, then that's really financial suicide"

Mistake #4 is Swinging for the fences.

It can be tempting to go for the big wins in your quest to build financial wealth. But doing this can also mean strikeouts which can be difficult to recover from.

The rational solution is to work to achieve sustainable long-term returns that compound over time. Don't get distracted by short term noise on wall street, but re-orient your approach to build wealth over the long term.

Warren Buffett said...."The stock market is a device for transferring money form the impatient to the patient."

Mistake #5 Staying Home (home-bias)

The tendency to invest disproportionately in markets that are familiar to you, like your own country's stock market, only one asset class, your own industry, or your employer's stock. Home bias can leave you overweighted in what you know, which can potentially wreak havoc on your portfolio.

The solution is to consciously diversify.....in different asset classes **and** in different countries.

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Mistake #6. Negativity bias.

The amygdala floods the body with fear signals when we are losing money. But when markets plunge, fear take over and it's very easy to act irrationally. Some people panic and move their entire portfolio to cash. The solution is simply to prepare. Maintain the right asset allocation or asset management style that will help you though volatility, and then partner with the right financial advisor to focus on the long-term

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