

## **A Mind Is A Terrible Thing To Waste**

by Doug Wakefield with Ben Hill

Once again, the holidays are over, and everyone has returned to work. Investors are looking at their end of year statements, as they roll in from 2006. As I reflect, it occurs to me that if managers did nothing but purchase two ETFs, one tracking the Dow Jones Industrial Average and the other tracking the S&P 500, their clients would draw comfort from the money earned and would likely believe that nothing could derail the upward march of the stock markets. No need to concern themselves with declining home sales and mounting inventories or that constant hot bed – the Middle East. Just look at the number on the statement. After all, that’s all you need to know, right? Investing is simple. Just go about your day-to-day life, and “leave the driving to us.”

A year ago this January, we released an industry research paper on short selling, “Riders on the Storm: Short Selling in Contrary Winds,” and started our monthly newsletter, “The Investor’s Mind: Anticipating Trends through the Lens of History.” Each month we have addressed a topic, with the goal of improving the thought processes of both investors and advisors around the world. One of these topics, which has impacted my own thinking over the last few years, regards the way we *perceive* the information with which we are presented. I elaborated on this idea in the opening comments of our December issue, as follows:

“As I turned forty-nine this past fall, it occurred to me that in the past four years I’ve learned more about the world of money, and the way we relate to it, than I had in all of my prior forty-five years. When I first started to truly understand the world of money, I was sure that others would be interested in my findings.

Yet, developing and distributing a DVD-film in 2004, quickly dispelled this illusion. By the time the 45-minute film was completed, my son had worked 50 hours on the technical aspects of the project, and I had spent about 500 hours in research and development. With 18 years in practice and the respect of family, friends, colleagues, and clients, I looked forward to distributing roughly 200 copies. The “responses” I received, though not anticipated, were seminal in establishing Best Minds, Inc.

Specifically, over the course of the next few weeks and months, no one thanked me for sending them this film. And though, as our paths crossed, a few individuals stated that they were impressed with the *quality of the film*, the vast majority of individuals never said a word.

After getting past my initial dejection, I realized that the implications of the material were so painful that it was easier to dismiss me, and the ideas in the film, than it was to deal with the probability that our world was going to change. Our natural inclinations are such that we are more likely to emotionally react, and label, than to think critically and deliberate. Blaise Pascal once said, “Ordinary people have the ability not to think about things they do not want to think about,”

and I agree. Until people reach a point where they are willing to consider undesirable outcomes, it doesn't matter how many resources suggest otherwise; their perceptions are unlikely to change.”

In seeking to understand why we label anyone who challenges our perceptions of reality, why we believe that the markets can go up indefinitely, and why we feel such enormous pressure to focus on our performance over shorter and shorter timeframes, I was fortunate enough to make Dr. Dorn's acquaintance.

In addition to trading futures for her own accounts over the last fourteen years, Dr. Dorn has a PhD in neuroanatomy from the [Albert Einstein College of Medicine](#), did her post-doctoral work in neurophysiology at New York Medical College, is board certified in general psychiatry and addiction psychiatry from the American Board of Psychiatry and Neurology, and has provided real-time web-based, and face-to-face [consultations](#) to over 600 traders and investors.

The following is short a excerpt from the same issue of [The Investor's Mind](#), in which Dr. Dorn and I were able to discuss how the brain perceives information:

“Doug – What I find fascinating, in regards to our thinking, is that if we look at a variety of cultures and nations, we find an enormous group of people living out their day-to-day lives under the premise that the one of the primary roles of government is to provide various safety nets. We have even come to believe that the greater the complexity, the safer the safety net must be. In a world where our morning fruit comes from one country, our transportation from another, and our computers from yet another, the elaborateness of our distribution system has given us a sense of stability and ease, when by the nature of its complexity, it becomes more difficult to maintain stability.

So, if I start thinking about change and the complexity of the system upon which I am relying, and I realize that I can't control all of these variables and that based on the level of spending to support this complexity, the status quo is unsustainable, then I become afraid.

Dr. Dorn – I agree, something's got to give. What happens in a situation like this is very interesting. When people are not thinking about *how* something is provided for their benefit – just expecting it to continue – they come to the conclusion that somebody else is going to take care of them; somebody else is going to think for them and tell them what to do, where to go, and what to take on a plane... So the more the government keeps establishing and/or expanding programs that will “protect us,” the more people feel this sense of security. Of course, this sense of security is completely false, and in the process, freedoms are taken away from us.

This issue is critical when it comes to making trading and investing decisions, and I'll tell you why. Let's say we're just moving along; everybody is taking care of

us; everything is just fine; the government is paving our streets as well as providing Social Security for income and Medicare to cover certain medical cost; we have this sense of being safe and cozy in this artificial environment that our government has created. The suddenly it is not there.

When an individual has been in the amniotic sac, when we have been “cocooned,” and then the cocoon is gone and we are presented with making choices that we were not used to making before, the neo-cortex [the thought center of the brain] becomes overwhelmed. Since, when placed under a great deal of stress, the brain cannot process this much conflicting information (upon which decisions must often be made) it defaults to the limbic system [the emotional center of the brain]. And by reverting to the limbic system, we make decisions purely on an emotional basis.

Doug – I think this is one thing that fascinates me when it comes to the dynamics of all human relationships. I may hear what you are telling me, and come to an understanding with my neocortex that what you are telling me is true, but because it scares me and/or frustrates me, I am going to *react* to those ideas emotionally, rather than join you in this thinking process. It is not that I cannot understand, but that I am afraid your conclusions could be correct, and I would have to contend with the very real probability that my daily world is going to undergo significant change.

Dr. Dorn – Yes. This is why, when we are faced with the process of thinking through significant change, we move from *responding* to the information to *reacting* to the information. Needless to say, this happens throughout the investing community when dealing with buy/sell decisions. When there is so much change going on, I see what I would call bipolar, manic-depressive, and attention deficit disorder/hyperactivity as factors that are plaguing our markets at all levels.

Also, managers’ performances are being measured in increasingly short time horizons. And, the more frequently investment performance is checked, the more likely one is to find a loss. For this reason, I would venture to guess that these types of emotional disorders are exaggerated by the emphasis on short-term time horizons, and that this is what has led to so much closet indexing. Since assets under management financially reward these managers, managers will always seek to prove that they are performing well. With an increased emphasis on short-term performance, they will automatically seek to keep from underperforming. Since the easiest way to keep from underperforming is to track your benchmark, it becomes very compelling for the manager to become a closet indexer.”

So, as we start 2007, if you are not sure how much of your future is tied to closet indexing, I strongly encourage you to get outside of your “cocoon” and start asking the question, “*How* did we make money in 2006?” While procrastination and denial have proven beneficial to the non-thinker over the last three years, let me remind us that not all

three-year periods look the same. And if one believes that the boys at mission control can print their way out of any mess, one must contend with how ineffective their actions were in stopping the market decline from 2000 to 2002.

ETF Type/Price	12/31/2003	12/31/2004	Ann. Return	12/30/2005	Ann. Return	12/29/2006	Ann. Return
DIA(Dow Jones Industrial)	98.48	104.34	<b>5.62%</b>	104.81	<b>0.45%</b>	124.41	<b>15.75%</b>
SPY (SP500)	107.05	116.62	<b>8.21%</b>	122.26	<b>4.61%</b>	141.62	<b>13.67%</b>
US Money Supply Increase			<b>6.30%</b>		<b>7.60%</b>		<b>9.60%</b>

ETF Type/Price	12/31/1999	12/31/2000	Ann. Return	12/31/2001	Ann. Return	12/31/2002	Ann. Return
DIA (Dow Jones Industrial)	106	98.26	<b>-7.88%</b>	91.97	<b>-6.84%</b>	77.97	<b>-17.96%</b>
SPY (SP500)	138.56	123.75	<b>-11.97%</b>	107.76	<b>-14.84%</b>	84.14	<b>-28.07%</b>
US Money Supply Increase			<b>8.64%</b>		<b>12.90%</b>		<b>6.63%</b>

\* The US Money Supply data is compiled from the [Federal Reserves Historical table on M3](#). Since the Federal Reserve saw no need to continue to present this information to the public after [March 16, 2006](#), I have turned to John William's [Shadow Government Statistics](#) in order to stay apprised of the same. The number for the 2006 M3 growth is William's November 30, 2006 calculation.

To read some of our other postings and learn about our [educational services](#), we encourage you to visit our [website](#). Our industry research paper on short selling, [Riders on the Storm: Short Selling in Contrary Winds](#), is available to those who subscribe to our monthly newsletter, *The Investors Mind: Anticipating Trends through the Lens of History*.

To learn more about Dr. Dorn's newsletter and coaching/consulting services, visit her at [www.thetradingdoctor.com](http://www.thetradingdoctor.com).

Doug Wakefield,  
 President  
[Best Minds Inc.](#), A Registered Investment Advisor

Best Minds, Inc is a registered investment advisor that looks to the best minds in the world of finance and economics to seek a direction for our clients. To be a true advocate to our clients, we have found it necessary to go well beyond the norms in financial planning today. We are avid readers. In our study of the markets, we research general history, financial and economic history, fundamental and technical analysis, and mass and individual psychology.

Copyright © 2005-2006 Best Minds Inc.