EPISODE 1134

*"**MH:** Doing well at investing, doing well with money is not necessarily about what you know or how smart you are or how sophisticated you are. So much of it and what matters is your behavior, your psychology."*

[INTRODUCTION]

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FT: Welcome to So Money, everybody. I'm your host, Farnoosh Torabi. We've got an incredible guest on the show today, Morgan Housel, author of the bestseller, *The Psychology of Money: Timeless Lessons on Wealth, Greed and Happiness*. It will be refreshing to hear how you don't need a Ph.D., or go to Harvard, or have extensive experience with money to become super wealthy or super rich. Instead, it takes discipline. It takes a certain mindset, certain behaviors.

A lot of things that we talk about on this show, but this episode and this interview really ties it all together very, very neatly. Talking about how behavior is the most important side of investing and managing your money wisely. You can be the best stock picker in the world, you can have the most sophisticated economic forecasts and models, you can be a genius, but if you don't control your own relationship with things like greed and fear and your ability to take a long-term mindset to know who you can trust, then none of those financial skills will matter. And that's according to my guest, Morgan Housel, author of *The Psychology of Money*.

Morgan is a partner at the Collaborative Fund and he's a former columnist at The Motley Fool and The Wall Street Journal. Here we go. Here's Morgan Housel.

[INTERVIEW]

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FT: Morgan Housel, welcome to So Money.

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MH: Thanks so much for having me.

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FT: It is such an honor to finally get to interview you. You've been on quite the book tour whirlwind. Your book is called *The Psychology of Money: Timeless Lessons on Wealth, Greed and Happiness*. My friend, Jason Zweig at The Journal calls it one of the best and most original finance books in years. Let's dive right in, Morgan. And first, thanks so much for being here. I know that you've got a lot on your plate, and we really are fascinated by everything in this book. Basically your thesis is that money relies more on psychology than finance with this book.

And so at first blush, this sounds a little relieving to me, because it sort of implies that you don't need a Ph.D., or you don't need to go to Harvard, you don't need to be this genius to become rich. But I suspect that you would say it's actually harder in some ways to develop the right behaviors to build wealth. But what is actually your take?

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MH: Well, thanks again so much for having me. And I think you really framed it right there when you said it can be relieving to understand that you don't need to be a Ph.D. from Harvard or MIT to do well with money, because so much of it is about your behavior. And what I mean by that is just, by behavior, I mean your ability to take a long-term mindset, your relationship with greed and fear. How gullible you are? Who you seek information from? Those kind of things aren't generally how we teach finance in the academic setting. But they tend to be what really matters over time. And one way that you can think about this is this, there are people who have no financial training, no background, no education, no connections, no resources. They work in totally different – Their janitors who live in the middle of nowhere that do very well at investing, because they have the psychology side down. They dollar cost average into index funds and leave it alone for 20 or 30 or 50 years and just let it compound into something great. And on the other hand you can have people who have Ph.Ds in finance from MIT who go bankrupt.

And I think the fact that those two stories can co-exist and do coexist in this world shows that doing well at investing, doing well with money is not necessarily about what you know or how smart you are or how sophisticated you are. So much of it and what matters is your behavior, your psychology.

One other similar analogy here is health and medicine where you can you can be a Harvard-trained doctor and you can understand everything about how the human body works in biology and have the best medical knowledge in the world, but if you still smoke and eat a poor diet and don't exercise, it's not really going to matter. So kind of like the behavioral side, the psychology side has the ability to supersede and neutralize any of the intelligence that you might bring to the table in this industry.

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FT: And you say, when it comes to those behaviors, the recipe is a combination of frugality and paranoia to be able to master your money. Can you expand on that? Because I don't consider myself super frugal. I am a little paranoid at times. I call it a healthy state of panic most of the time for me.

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MH: That's good. I like it. I think there're two sides of money, and how I phrase it in the book is getting rich versus staying rich. And they're two completely different skills and you kind of need to master and hone both skills to do well over a long period of time. Getting rich requires being an optimist, swinging for the fences, taking a risk being, being a long-term thinker. That's what you need to kind of get rich and build wealth over time. Staying rich is almost the opposite. Staying rich I think requires a certain level of paranoia and pessimism about the short run. It requires acknowledging that over the course of history, history is kind of a constant chain of recessions and bear markets and businesses going on your company's going out of business, stocks that you own that are struggling. And being able to survive that short-term chain of disappointments is what you need to do in in order to stick around long enough for compounding to work for yourself in the long run. One other way that you could summarize this is saying that people should save like a pessimist, but invest like an optimist. You need to save like a pessimist so that you can stick around long enough to benefit from the long-term compounding that we will benefit from as long-term investors.

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FT: How important is your environment though, right? The family you grew up in? The community that you were raised in? The school – I mean, I know like it doesn't matter if you went to Harvard, but there is something to be said about gaining literacy and access and some people have more of an advantage to that than others and that does give them a leg up when it comes to managing money well.

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MH: I think, to me, it's less about your education background. That's certainly part of it. But to me it's just that we all have a different experience in the world. What I've experienced throughout the course of my life is different from what you've experienced, which is different from what everyone else is. And if we talk about people in different countries from different generations, we've all seen a totally different view of the world. We've experienced different things. Even among my siblings. We have the same parents, the same social economic background. We've had very different experiences in life that leads us with just a different model of how the world works. What we expect from the economy, from the stock market, from the jobs market. we have different expectations.

And therefore, what I think is important about that is when we have a different view of how the world works. We're all going to come to slightly different conclusions about what works best for the decisions that we make with our money. So I might invest differently than you do and you might invest differently from someone else. You might spend more of your money than I do and someone else might spend more than you do. It's important to realize that because we have different backgrounds, different experiences and have different views of the world, that we're all going to make different decisions with our money, and that's okay.

Money is not like math where two plus two equals four for me and you and everyone else. It's the same. It's universal. Since we're all just trying to figure out, "Okay, we have some money coming in. And here's my view of how the world works. Here's how I'm supposed to spend. Here's how I'm supposed to invest." And therefore equally intelligent educated people can come to different conclusions about the right investments that they can make, the right level of spending that they make, the right amount of debt that they should have. There's no one-size-fits-all answer for everyone. And I think it's important to just kind of be introspective about yourself and try to figure out who you are. What matters to you? What decisions are best for you? And make decisions that work for you even if they don't work for someone else.

And I think a lot of the debates that we have in the financial industry, particularly in the investing industry, are not so much that people disagree with each other. They're just reflections that people have very different views of the world. And, again, equally smart people can come to different conclusions. And if something works for you, if a financial plan works for you, if an investing strategy works for you, then I think that's the right one for you even if it doesn't work for someone else or someone else disagrees with it.

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FT: The book has been incredibly successful, Morgan, and it is talking about something that isn't super new. I mean, we've known for a while that our emotions our behavior make an incredible impact on our ability to make healthy financial decisions. However your way of presenting this, the storytelling and really getting people to think a little bit differently about behavior versus math is outstanding. So tell us a little bit about your process for writing this book and why you think it has been so well-received.

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MH: Well, I think it kind of starts with my background as a financial writer. I started as a writer around 2008, which was of course was the beginning of the financial crisis and that big recession that followed that. And at the time, as a writer, I was trying to answer the questions, "What happened? Why did the financial crisis happen the way it did? Why did people make the decisions that they did? Behave the way that they did? And have we learned anything from it?" And I started to realize that the answers to those questions could not be found in an economics textbook or a finance textbook. The answers to those questions just did not exist in that field, but you could find subtle clues about why the financial crisis happened through the lens of a psychology textbook, or sociology, or political science, or history. Those are the fields that held the answers and could start to explain why people behave the way that they did, which for me just opened up this idea that, again, investing is not the study of finance. Investing is a study of how people behave with money. And behavior is a really broad field that finds its way across all kinds of different disciplines.

And then that just opened up this idea that you could learn a valuable investing and money insights through the lens of other fields that had nothing to do with investing, but also had to do with how people make decisions around greed and fear and scarcity and long-term thinking. So most of the chapters in this book start with a story that has nothing to do with investing. Stories about ice ages and different kinds of medicine and whatnot, but I'll have a very clear investing takeaway that we can learn about how people think about risk and whatnot. And I think once people view investing through the lens of other fields, it becomes less daunting, because particularly if you are new to the industry, but even if you're not, investing is lots of formulas and charts and data and math. And once you can realize that, "Actually, no. It doesn't have to be daunting like that." You can view this as a field that's easier to wrap your head around, something like psychology. Then it becomes more accessible to people.

And even if you are not new to the industry, I think a lot of the things in investing are just not intuitive. So a lot of the concepts around how compounding works and what not. Even if you understand the math, it's not intuitive. And the best way to understand something that is not intuitive is not by looking at the data, looking at the math. It's hear a story, an easy to understand story that really puts things in perspective. So I think I hope that's part of why it's done well so far.

One other thing that was really important to me just in terms of the structure of the book is that the chapters are very short. I think readers are very impatient, particularly in the modern day when they're used to Twitter and Facebook. People don't have patience for long, drawn-out, rambling reading. So each chapter is fairly short. I make a point. I try to do a good job explaining that point and then I get out of your way and I move on to another point.

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FT: Is there a behavior that you are still trying to master when it comes to money, Morgan? Is there something that you're still working through um as far as being able to get the right mindset or psychology to make certain decisions around your money?

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MH: Well, I think there's two things that I keep in mind here. One, this gets back to our own unique experiences and backgrounds. I am a college educated white American male, and that has been a set of experiences for me that I know is not what everyone else in the world has seen as well. And through no fault of my own or anyone else's fault, we've seen a different part of the world, and I try to go out of my way to be more open-minded to the viewpoints of other people given that. And I think that's something that I want to pass on to my children as well, is that people view different – People had very different experiences in the world through no fault or skill of their own, and it's important to go out of your way to understand other people's experiences so you have a broader view of how the world works. I think that's always a part of the psychology of money that I try to think about for myself.

The other thing is you know I think my wife and I are – And I explain a lot of this in the book where I talk about our own personal finances, but we don't spend a lot of money. We have a very high savings rate. And that's good. That's how we want it, because we just want independence out of our money. We don't want a lot of fancy things. We just want freedom and independence. But there are times when my wife and I ask like, “Are we missing something? Should we be spending more? Would we be happier if we spend a little bit more?” So that's always a difficult decision to make. And usually the answer when we ask that question, usually the answer is no. But I think it's something that we always struggle with. If you are someone who does have a high savings rate, I think once in a while you'll always kind of become a little introspective and say, “Maybe there is something that I’m missing here, that I would get a lot of joy at if I spend money on.” So that's always something that we think about as well.

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FT: Prior to the book, you wrote a very popular blog piece that I think I got over a million views. And it was a breakdown of 20 flaws and biases and causes of bad behavior. I'll put the link over on our website. And I really liked the first one, which was that earned success. And, again, these are flaws, biases, causes of bad behavior when people deal with money. Number one, earned success and deserved failure fallacy, which is you explain as a tendency to underestimate the role of luck and risk and a failure to recognize that luck and risk are different sides of the same coin.

I thought this was really spot on especially given the world that we live in today. So much of personal finance success, we talk about the individual's journey and pulling yourself up by your bootstraps or working so hard that, of course, you deserved all the success and you earned it. I'd love for you to give us a different spin on this and maybe have us think differently about this, because it's important.

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MH: Well, there's a story that I tell in the book in chapter 2 about Bill Gates. And Bill Gates went to the only high school in the United States that had a computer. Now, look, is Bill Gates hard working? Yes, of course. Oh my goodness! He is. Is he a genius? Yes, full stop. Is he a business visionary who took a huge risk, a huge gamble to create Microsoft? Yes. 100%. But is Bill Gates also insanely lucky for the fact that by no thought or effort of his own he ended up at the only high school in America with a computer? Yes.

He admits this himself. He gave a commencement speech at his high school several years ago where he said, "Without lakeside school," which is the school he went to," there would be no Microsoft. So I think it's easy for us to overlook the role of luck in life, because if you talk about luck, you start to look like you are jealous. If I say Bill Gates is lucky, I look envious or rude. And if I say that I myself got lucky, then it's hard for me to look in the mirror. So it's easy for us to sweep luck under the rug even if we know it exists and it plays a huge role in outcomes. And I think the same is true on the other side with risk.

I also tell the story in the book about a guy named Kent Evans, who was Bill Gates best friend in high school. And by Bill Gates own definition, Kent Evans was smarter than Bill, more ambitious than Bill, understood computers better than Bill. And their idea, Bill and Kent's idea, was that they were going to go to college together and then start a company together.

So Kent Evans could have been the driving force behind what became Microsoft. He could have been more successful than Bill Gates, but Kent Evans died in a mountaineering accident when he was 18-years-old. So that was just a dumb – That was just a stroke of dumb risk that happened, the opposite side of dumb luck. He got hit by a stroke of dumb risk.

So I think I feel like those are of course are very extreme examples. You have the richest man in the world almost and someone who died at age 18. Those are very extreme examples. But it's easy for us to underestimate all roles of luck and risk. And I think just the observation that not all success is due to hard work and not all failure is due to laziness is really important for judging other people's success and your own. So it's just something that's easy to overlook when we're dealing with money issues.

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FT: Yeah. And like I said, I think right now, it's a really important reminder as so many people have lost their jobs or they can't make next month's rent to no fault of their own. They did save you, but this pandemic has been so difficult and has exacerbated what would have been a typical recession is now an extremely – I mean, compared to 2008, we had it much better in 2008 and 2009 than now in some ways, because we don't want to also deal with like a life-threatening health crisis on top of losing our jobs. And so advice for anyone hearing this, like it's not your fault and some things are just dumb risk and dumb luck, but then not to say like just sit with that. There is something to be said about what's the next behavioral step that we have to take after we've accepted that dumb luck or dumb risk. What has to happen after that in order for us to see success?

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MH: I think there's two sides of this. One is just being more empathetic towards other people and yourself that, on one side, being careful about who you look up to as a role model and realizing that Bill Gates or Warren Buffett or Jeff Bezos. Yes. Should those people be role models? Sure, I think that's fine. But be very careful about the lessons that you take away from those people, because you cannot emulate Bill Gates' luck. You cannot emulate Warren Buffett's luck. You can emulate their skill, but you have to really be careful about how you separate luck from skill in that thing.

So I think it's important to take away really broad 30,000-foot view lessons from those role models that you look up to. But the more specific the lessons are, the more likely that you were getting into something that was a part of their success that was driven by luck that you will not be able to emulate. That's one side of this.

The other side of it is how important room for error and endurance is in financial matters, because when you realize that there are things in the world that can happen totally outside of your control that have a bigger impact than anything you do intentionally, which is what risk is. That's the definition of risk. Then you realize that you need to be prepared for things that are going to happen to you financially that you don't see coming and could be devastating, whether that is a job loss or a huge bear market, whatever it is. So much of what is important in investing is just your ability to endure. It's just – Can you withstand a job loss? Can you withstand a 30% bear market? Can you withstand a recession? If you can do that, then you put compounding in your favor. Like as long as you can remain in the game and remain standing and be able to stick around as an investor for 10 or 20 or 30 or 50 years, that's when the big fortunes come from. That's where the big results come from. It's not necessarily how smart are you or how good of an investor are you. It's can you at least just be a mediocre investor for the longest period of time? And that time horizon is just a factor of your endurance. It's not can you avoid risk? It's can you put up with it and endure it and be stable over time? So that is when you realize how risky the world is, you realize how important endurance is for finance.

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FT: It begs the question though, Morgan. Right now, so many people are struggling with mental health, right? Whether it's depression, anxiety, social anxiety, because the world is a scary place. And if that's the lens through which you're looking at the world, all the scary things, how can you possibly endure enough to make any decision, let alone healthy investing decisions? And so can you speak to the times a little bit and how all that you've learned, does the advice hold through the test of time given that right now where we are in the world is we're dealing with people or maybe we've always had people who've struggled but now we're only spotlighting it more? But I have to wonder if it's also been increased in the pandemic and in so much uncertainty in the world.

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MH: I think just the idea that history is written by the by the victors or by the survivors in this case is important, because I could tell you a story about something like at the end of World War II, Germany's economy was completely devastated. GDP was down more than 50%. There was almost nothing left of the economy. It had been bombed to rubble by the allies. But it took less than five years for Germany to completely rebuild its economy and have its GDP exceed its pre-war high. So that is something where I could say, "Look, there's actually a long history of economies and nations coming back stronger, faster than anyone else thought possible." But the nuance of that story is that is true if you were a survivor of World War II, if you were one of the ones who died or if you lost a husband or a son or a daughter in that war, then it was very different. So there's always a side of this of being an optimist about your ability to recover, your company's ability to recover, the nation's ability to recover. But it's only if, again, – That's only if you can survive and stay in the game. And if we're talking about financial matters here, it is the case that we will recover from COVID-19. If we're just talking about the financial impacts and the economic impacts, we will recover. We already have substantially.

And going into '21, if we have a vaccine combined with pent-up demand, combined with another stimulus package, you could make the case that 2021 could be an amazing year for the economy. But that's only if you survived. If you're a small business that didn't make it this year, and there are millions of those, then they're very different story. So this just gets back to how absolutely critical and fundamental room for error is in investing and endurance is in investing. And not just investing, but all financial matters, small business matters, personal finance matters. Your ability to endure shock and hardship matters more than anything else we talk about in this industry, in this field. It matters more than where the stock market's going to go next. What the next hot stocks are? All of that is secondary to your ability to endure shock and hardship.

So I think 2020 has just been such a blunt force reminder of that, that during the Great Depression, for example, you had industries where their business was down 20%. That was a devastating blow during the Great Depression. In 2020 we have industries where the revenue is down 90%, sometimes 100% if we're looking at restaurants that had to close. So a completely different level of risk than I think a lot of people thought possible. But if you are able to endure, then we will be able to recover. But it's a brutal time for a lot of people.

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FT: Yes. Back to your personal financial money moves, I read that in your 20s, you were a big stock picker, or maybe not a huge stock picker, but you had about 25 different stocks that you owned in your portfolio. Today you invest exclusively in low-cost index funds. We live in a world where CNBC and Fox Business is always about like how to play the news and how to pick your stocks. And I wonder, is that doing us any favors?

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MH: I don't think there's any evidence that we are better investors today in the information era than we were 30 years ago. It might be the case. There might be data out there that we are on average like in aggregate better. But I haven't seen that information. So I think on net, it probably does do harm to most investors. I mean there is a lot of research about investing returns are heavily correlated to the amount of activity you're putting in. If you trade more, you're going to do worse. If you trade less, you will probably do better. For most investors, that is the case. And I think the information that we have out there, whether it's CNBC, or Yahoo Finance, or Twitter, whatever it else is. By and large what that does is it encourages activity. It encourages you to go out and buy this, sell this, do this. So I think in that sense I think we are probably worse off.

Now I consume a lot of financial news and media myself, but I do it because I’m just trying to figure out how the world works and I’m curious about it. It doesn't tempt me to act at all. So if you can do that as an investor, you can watch CNBC and read Yahoo Finance all day long if it doesn't tempt you to make many decisions, not zero decisions, but just not many decisions. But if you are someone who watches CNBC and at every commercial break you log on to Etrade and make a couple trades. That is over – That is very likely to be leading you in the wrong direction. And people can laugh at that, but that is the era of Robinhood. Like Robinhood is the gamification of investing, where the whole point of it is to keep hitting the buttons and pull the levers and turn the knobs as much as you can.

So there's a part of me that is glad that the Robinhood phenomenon, that by and large those investors are very young, that they will learn these lessons about risk early on in their life. They'll learn the lessons when they're 19 instead of 48 and trying to put their kids through college. So maybe that's a good thing, but I also think there's a side of the gamification of investing that is dangerous, because people's money is not a game. It has real-life consequences.

There was a story earlier this summer that many people saw of a Robinhood investor who I think he was 19-years-old. And he logged onto his account, and it was a UI error. This wasn't even a real number, but he logged on and it said his account balance was negative 700,000. It wasn't actually that. It was just a glitch on their end, but he killed himself the next day and he wrote a letter explaining that he did this because of Robinhood.

So I think like we have to realize that investing is not a game. These are real people's lives and you can really hurt people fundamentally when they lose all their money. So there's a part of me that really wants to get moralistic about this and say it's not right what's happening in the industry, whether it's Robinhood or the media that is really designed for engagement and activity. But I think it's the world we live in regardless of what I think about it. But it's it was true 30 years ago and it'll be true 30 years from now that the investors who do the best on average are the ones who make the fewest decisions and have the least amount of activity within their portfolios.

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FT: Well, Morgan, we so appreciate your book and the stories, the perspectives really getting us to think. And going back to what I said earlier, I do think, really, it's so empowering to know that we do harbor and hold so much of the power to make the healthy decisions with our money. You don't need the Harvard degree. You can tune out you know Fox Business if you want. You're still capable. And I think that that is a great gift that you're giving people that reminder and that knowledge. And we so appreciate you. Thanks so much.

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MH: Thanks so much for having me.

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