EPISODE 453

[SPONSOR MESSAGE]

[0:00:34]

FT: Welcome to So Money everyone, I'm your host Farnoosh Torabi. Thank you for joining me. We're covering a subject matter that's very exciting to me, I wrote a book called *Psyche Yourself Rich* back in 2010 and it was really about behavioral finance and how as humans, we're not exactly "rational" when it comes to things like investing and saving and being smart with our money. I wanted to explore why, since then I've been really interested in new studies and new ideas around this.

Our guest today is a psychologist and behavioral finance expert who has got some new answers and some new research for us. His name is Dr. Daniel Crosby, he's the author of a new book, came out earlier this summer called *The Laws of Wealth: Psychology and the secret to investing success*. It's a fun book, if I dare say. Sometimes books at this high level, written by PhD's can be, well let's be honest, a snooze fest.

But this book does a really excellent job of making it accessible to readers, giving service and great take aways for us to really learn how to be better at managing our own money and investing. He gives readers real and actual guidance for investors like forecasting us for weatherman and if you're excited, it's probably a b ad idea. It's funny too. Daniel also co-authored a New York Times bestseller before this one called *Personal Benchmark: Integrating behavioral finance and investment management*.

Daniel and I, we talked about how as humans, how can we begin to think more rationally when it comes to investing? It's not like we're born knowing how to do this so help me out here. Then earning versus saving as human beings, which are we more capable of doing? You might be surprised.

Here's Dr. Daniel Crosby.

[INTERVIEW]

[0:02:22.3]

FT: Dr. Daniel Crosby, welcome to So Money, it's great to have you.

[0:02:26.0]

DC: Thank you, great to be here.

[0:02:27.5]

FT: Congrats on your new book *The Laws of Wealth: Psychology and the secret to investing success*. This is one of my favorite topics and actually I was poking through your book, I have it in front of me here and rule number three is, "trouble is opportunity", which is awesome. I think Warren Buffett would also agree that when the sky is falling, that's when you're supposed to be keeping your focus sharp and trying to find some opportunities.

Would you say right now with so much uncertainty right now with the upcoming election and what's happening overseas and ongoing geo political concerns that maybe now is actually a good time to invest more than others? How would you characterize our current markets right now and how we should be behaving?

[0:03:12.4]

DC: Yeah, it's a little bit tricky because another one of the chapters talks about the power of diversification and I think you see that right now, because right now, the US equity market is actually enormously expensive, the broad market is. But European markets are actually quite cheap. I think yeah, I think people that are broadly diversified are going to have a fine run of it but I think the US and the medium term will probably not do very well, if history is any indication.

So I think it speaks to the importance of being diversified and really going where there's blood in the streets. I mean if you look at where the real turmoil is right now, it's in Europe and prices are cheap accordingly. It's interesting though, in the US, we've had this since for a long time but we're not very optimistic. But in a very sneaky, in a very stealthy way, US equity markets have actually kept up a quite high evaluation levels over the past seven years and no one's really noticed because it hasn't felt all that exuberant frankly.

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FT: No, it hasn't. One of the great things about your book is that while you lay a lot of this principles down, you also give a lot of action in the book. Every chapter ends with, "Okay, thanks for this information Dr. Crosby, what now?" It's like one thing to kind of explain theories to people and people really want to take aways.

Did you find that when you were doing your research for your book that that was something that was missing from a lot of books that were, you know, it's a very high level book, you approach this one very academic perspective but also a lot of experience too. Did you think that there really isn't, aren't a lot of books out there that gave you actionable advice when it comes to behavioral psychology and behavioral finance?

[0:05:00.2]

DC: That is what I thought, and I really have my editor to thank for that because he's the one that really pushed me towards greater concreteness and greater applicability. That's not naturally where my head goes. As a PhD, as an academician, I think most of us that go that route sort of have our head in the clouds and can tend to be a little ivory tower and as a result, a lot of the books out there and many of them are fabulous and have really shaped the way that people think about investment management for all they did well, they weren't all that applicable.

So I think the crowning glory of this book, if there is one, is that you can actually take this things and it will give you steps for applying them because really, at the end of the day, these ideas are only as good as your application of them.

[0:05:48.8]

FT: Do you think that as human beings we are actually capable? Look, the problem is that, and I'm sure you know this, is that we're not exactly hard wired to make "rational" choices when it comes to the stock market and investing. We're very emotional beings and so, what's your best advice there? Because to get over those emotional barriers that we have and those impulses, because we're not born, equipped with the know how or the wherewithal.

[0:06:20.8]

DC: I make the case in the books, I introduced this paradox early on that says there's two incompatible things that work here. The first is, you absolutely have to invest in risk assets if you're going to survive. I mean, I sort of do the math and say, "Hey, even someone with a very nice salary, if they're not compounding their wealth, had a decent clip. You're just not going to make it."

We're living at a time now where today are the average retirees spends a quarter of a million dollars in retirement on medical bills above and beyond what their insurance covers. It's just enormously expensive to live as long as we are now and our medicine has sort of out paced our investment acumen and what the markets have given us. So I say, "You know, on the one hand, you have to do this." But on the other hand, as you point out, for very poorly equipped for this.

Sort of the apparatus that we come to earth with just makes us very poor investors, it makes us emotional and short sighted and greedy and fearful and everything you don't need to really make the most of investing in capital markets. So I think if we're just going to be simple and give one piece of advice here, one thing I talk about in the book is just automating these things at every turn just really automating the processes by which you go about investing.

Because there's a study that I love to talk about that I site in the book that's a meta-analysis, which is a fancy word for this study of all the studies. So a meta-analysis of human decision making and human discretion versus just following rules and it shows that following simple laws or simple rules beats PhD level human discretion, beats or equals it 94% of the time and certainly does so at much slower cost. So I think most investors should just absolutely automate the process by which they go about this to avoid all the messy humanity that comes along with it.

[0:08:25.4]

FT: I totally agree. At the same time, it's important to still have a relationship with your money and critics would say, "Well if you automate everything, you create distance, you lose touch." So how you reconcile that?

[0:08:38.7]

DC: Yeah, another thing that I try to do in the book here is so much of what's been talked about with respect to behavioral finances, sort of the myriad ways in which we're flawed and silly and stupid and irrational and I want to say, "Hey, there's ways to take the messiness of being a human being and flip it on its head a bit so that you can actually use that to your advantage." So one study I talk about in the book talks about what's called "goals based investing" or just benchmarking the things that are important to you, to your personal meaning and purpose rather than trying to outpace the S&P 500 say.

It talks about this one study where low income savers were trying everything they could to set aside more money and the folks that were studying this low income savers, rewards, they tried punishments and everything that they could think of and then finally, the only thing that worked was priming them with a picture of their children. So before they would make a decision whether to save or spend their money, they were asked to ruminate on their children and look at a picture of their children.

When they did something as simple as that, they saved more than 200% as much as they had been previously. So I think there's a way to introduce life into this process in a way that makes it less sterile and actually gets you moving in the right direction.

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FT: I don't say this nicely as you do and with as much research but I have the sense that when we start to think of money as less about numbers and graphs and charts, which like you said can feel very stoic but to think about your goals. Think about who is important to you, what is important to you, what do you want to achieve? All that stuff carries price tags and so trying to first identify the goals then reverse engineering it with financial strategy I think is a much more — it's a more exciting way to go about life and it's, like you say, can ultimately lead to more success with your finances.

[0:10:39.5]

DC: Absolutely, you know, one of the reasons people have such a hard time investing and saving is because you're basically saying "no". I mean it's moment of self-depravation for a hoped for future outcome and that's nothing that we do well is trade off the certain pleasure of the moment for a hope for pleasure in the distant future.

[0:11:02.8]

FT: Call us crazy, call us irrational, yeah.

[0:11:05.2]

DC: Yeah, the only way you can do that is by having a "yes" that's bigger than that immediate "no". So for most people, that's the only thing that's bigger than that pain of the moment, it's something really important or someone that they really love.

[0:11:20.6]

FT: What's your take on this debate right now, which I'm on the earning side of the debate. But earning versus saving, which is more effective if we do have this adverse reaction to saving because who wants to save? Do you advocate for focusing, refocusing on how to earn more instead? Are we better at that as humans?

[0:11:40.7]

DC: Goodness, it seems like a little bit of a false dichotomy to me. I try and maximize both and I see them as going sort of hand in hand. I think, to your point, something that people don't appreciate is how much investing in their human capital can help them earn an appropriate living; reading books, getting a degree, making connections, building those relationships. These are going to be huge predictors of how you do financially over your lifetime.

But I think saving and saving early is a huge deal. I mean compounding is just magical, there's no two ways about it. So I think those things go hand in hand and I wouldn't begin to presume to say one's better than the other.

[0:12:29.1]

FT: But from maybe a behavioral standpoint, does one come to us more naturally? Like to be able to work in exchange for currency as supposed to not spending the currency.

[0:12:41.9]

DC: Sure so I think in terms of what comes to us more naturally, I think we have a natural drive towards achievement, maybe that takes the form of earning more and we have — there's nothing natural about the need to save. I mean I'll be very direct about that, that's nothing that we do well, that's nothing that throughout the history of humankind, people have even needed to do well. Life used to be nasty, brutish and short and you didn't need to plan for a 30 or 40 year retirement.

So we're kind of feeling our way in the dark here. I will say, there's something called the "hedonic treadmill", which is a fancy word for saying, as you earn more, you tend to spend more and as I sit here in my house that's too big that I bought because I made more money, that's kind of how that goes. We have a natural drive for achievement but we have to make sure we don't have a commensurate rise in consumption or else it's no good.

[0:13:37.8]

FT: Right. Makes total sense.

[SPONSOR BREAK]

[0:13:41.8]

FT: Need a website? Why not do it yourself with Wix.com? No matter what business you're in, Wix.com has something for you. Used by more than 84 million people worldwide, Wix.com makes it easy to get your website live today. You need to get the word out about your business, it all starts with a stunning website.

With hundreds of designer made customizable templates to choose from, the drag and drop editor, there's no coding needed. You don't need to be a programmer or designer to create something beautiful. You can do it yourself with Wix.com. Wix.com empowers business owners to create their own professional websites every day.

When you're running your own business, you're bound to be busy, too busy. Too busy worrying about your budget, too busy scheduling appointments, too busy to build a website for your business and because you're too busy, it has to be easy and that's where Wix.com comes in. With Wix.com, it's easy and free. Go to Wix.com to create your own website today. The result is stunning!

[INTERVIEW CONTINUED]

[0:14:42.6]

FT: I want to learn more about you Daniel. What kind of a childhood did you have that led you down this path of studying human psychology, behavioral psychology, finance, so deeply? Did you have interest in this as a kid? Do you think looking back, it all makes sense now?

[0:15:02.2]

DC: Oh it all makes a lot of sense. So I'm the son of a financial adviser and so grew up absolutely steeped in these things. I remember getting a copy of *The Richest Man in Babylon* when I was like a little kid and my dad sort of lecturing me on these things. In my household, the word "debt" was quite literally a four letter word. We were not allowed to say the word "debt" with the same degree of severity that we weren't allowed to say swear words, I'm not joking about that. So yeah, I grew up in a house where this things were very much top of mind.

I began college as a business major, seeking to study investment management. Then went on a mission for my church for a couple of years, spent a few years in the Philippines teaching English lessons and helping to strengthen local branches of my church and came back with a bigger heart perhaps than I left with, and so said, "Hey, now I want to study psychology, I want to do good in the world," and so over time, I've started blended this two aspects of who I am and the weird hybrid that exists today.

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FT: So I have to ask, why was debt such a terrible word? I think all families would agree, they would like to raise kids not praising debt, they would agree that your parents did a good job. But why was it such a specific point of education? Did your parents go through a battle with their own finances?

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DC: I think part of it was because they had, at least my dad had grown up poor and it was sort of seen as an encumberment and a problem. I think a big part of it, it's interesting, my dad is actually moderated his ideas about debt over time and has encouraged us to not do some of the things he did. Like when I was growing up, I very specifically remember no family vacations, eating just gross food while my parents were trying to pay off this house.

They went after paying off the house and very aggressively and did it at quite a young age. I think before, they were even 40 years old, but our family really kind of suffered for this and now they have a whole lot of money and they don't have that time back. So he's actually moderated his views on that and sort of preaches something different to their grandchildren because it took such extremes in my youth that I think we missed out on some things.

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FT: What do you wish you had learned differently growing up and what kind of experiences do you wish you had given that your parents were pretty frugal?

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DC: Yeah, I think just family time. I mean we spent a lot of time as a family but just making them raise outside of a home, I had a great childhood and we had a lot of fun at home but we also ate a lot of tuna casserole and so I think if we had just maybe loosened the belt a little bit, had more trips to Disney, more family vacations because I've made a point of taking my kids all over the country and the world because it's something as sort of a reaction to the way that I grew up. Now my mom's in poor health and they have all the money they need and don't have the opportunity. So that's something I really tried to learn and something they encourage us to do differently.

[0:18:34.2]

FT: You've read the studies, right? Money doesn't buy happiness, but there are some ways to appropriate your dollars that can increase happiness levels. Do you know what I'm talking about? Have you heard about that? Yeah. So can you share with us a little bit about maybe some of the best ways to spend our money, to live happier lives, are there ways?

[0:18:56.5]

DC: Yeah, so one of the ways are spending on relationships and experiences. People find that buying things has a short bust of happiness in particular is a house. Like a big house, very quickly just becomes the backdrop against which your life plays out. Very quickly we become desensitized to a very nice house. So houses do an especially poor job of providing happiness. Once you get the bases covered and you have adequate space and a warm, dry place, it doesn't do a whole lot.

Experiences on the other hand get better with age and this tend to live in our memory, often times, frankly getting better over time. We forget about the kids whining about, are we there yet and things and the sort of rosier parts of that recollection persist. So spending on developing relationships, making memories, having experiences are consistently better than buying things.

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FT: That's good to know, no big house is ever going to make you happy because that's a pain in the butt that big house. The maintenance, the breakdowns, the whatever. Yeah, home ownership is not for the faint of heart.

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DC: We bought a big house about nine months ago and it's the dumbest thing I've ever done.

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FT: For you especially, right? As the man of the house, you're probably the one that — the assumption is you're going to be able to fix everything. You can't.

[0:20:25.8]

DC: That is an assumption. My wife's much better at this things than I am.

[0:20:29.9]

FT: There's always Task Rabbit.

[0:20:32.1]

DC: That's right.

[0:20:33.3]

FT: Tell us about a boo boo, a financial mistake that you've made and indulge us because we may think that someone with a PhD and writing a book called *The Laws of Wealth* has made no financial mistakes but I'm sure there's something you might have learned the hard way?

[0:20:50.1]

DC: In terms of a financial failure, there's something that materialize recently. You know how I grew up, we knew that we were very debt averse in our household. That's taken a form of me really not having a credit card until very recently, we pay cash for all our cars, I have no student loan debt or anything like that. So we run a cash only operation more or less.

Well when we went to move from Alabama where I'm from to recently we moved to Atlanta, we went to check our credit scores in order to get a mortgage and assumed that everything was going to be in excellent shape just given the way that we live our financial lives. When we looked at our credit score, my wife had excellent credit, the small bit of credit, we do have is in her name. She does all of her household finances and her credit was excellent. Any credit we had, we paid off every month and it was all in her name.

In my name on the other hand it was basically no credit history to speak of except it turns out when I moved offices a few years ago actually, I didn't know about a final Verizon phone bill that I had due. A $200 bill that I'd be able to pay, hadn't left a forwarding address so it got sent to collections. So on my credit, I had almost no credit history into this sort of this black mark of this, having been sent to collections and so my credit was very poor.

Well when we were going to get the house, my wife stays at home with our children so she has no income, I have good income, bad credit, she has good credit, no income and so we actually had to put down nearly a 50% down payment to secure the house we moved into.

[0:22:33.1]

FT: All because of a utility bill that goes into collections?

[0:22:37.7]

DC: Yup, $200 bill. That of course I paid as soon as I found out about it. I paid it, assuming that all would be well with my credit now and apparently that's not the case.

[0:22:50.8]

FT: Oh man, we hear a lot of credit tragedies like stories about "I have my student loans or I went defaulted on my mortgage". But this seems like so innocent. In hindsight, do you think there was anything else you could have done? Could there have been a way to write a letter, have like a credit bureau write a letter and say, "Hey, this isn't an unusual score and this guy has perfect credit, it was just like, one bad thing led to another, he never got the bill, et cetera"? I mean there has to be a way to work around stuff like that.

[0:23:22.3]

DC: There has to be, and you know what's funny is I was actually scolded by my, the guy who did our mortgage because I had paid it off, as soon as I learned of this thing, I'm like, "Oh no, Verizon, I'm sorry I stooped you for $200 bucks, here you go, wrote them a check," and so then it's gone.

Actually, he told me after the fact that you really want to try and dangle that $200 bucks, you want to say hey, we'll write a letter, can you do something for us and use it as almost a bargaining chip. Because I had sort of taken myself out of the equation so quickly by paying it promptly once I knew about it, I actually did damage. It seemed flukey to me, we had to get all of our — we got a credit card, it's in both of our names now and lesson learned I guess.

[0:24:13.7]

FT: Lesson learned. Well hey, maybe it's great that you have all this equity in your home, that's one way to ride out a tumultuous market if there ever is one again.

[0:24:23.1]

DC: There will be.

[0:24:23.5]

FT: There will be? Okay, tell me everything. What's your crystal ball telling you actually, that's a good question right? I know that one of your laws is like, forecasting is for idiots or something like that but am I thinking right?

[0:24:39.2]

DC: *Forecasting is For Weathermen*, I was a little more gentile about that.

[0:24:42.6]

FT: Idiots, weathermen, same idea I guess. But well, is there a way for us to kind of see the future and work accordingly or is the advice just don't worry about the future, do what you can control?

[0:24:57.1]

DC: There's two of the laws of wealth that I talk about on book or one is for *Forecasting is For Weather People* and then the very next chapter is that *Excess is Never Permanen*t and so it's a bit of a tough thing. On the one hand, David Dreamin in this sort of fabulous value investor, looked at all the consensus forecast over the last hundred years or so, it was like 80,000 forecasts he looked at and he found that one time in 170 were the consensus forecasts within 5% of the eventual reality. So just horrible, I mean worse than throwing darts basically.

Then on the other hand, we know that excess is never permanent and we know that we're looking at right now, one of the most expensive American stock markets in the history of the US. I mean we're talking probably number four most expensive with the other three being 1929, 2000 and 2007. We don't know when but we know at some point, those excesses will get worked out of the market and the hard part is knowing when and that's sort of the unknowable part, which is why you just have to stick to your discipline, dollar cost average, diversify and ride out the storms.

[0:26:12.4]

FT: Not make any knee jerk reactions. In some ways, if you are a young investor with a long investment horizon, I would look forward to that in some ways only because that's an opportunity to strike and if you have some cash on the sidelines to put your cash to work. I know when news of Brexit broke, everybody was like, "Oh my god, the world is ending," and you can definitely look at it that way but I think from an investment strategy perspective, I was thinking, "This is the day that I'm going to go in and maybe buy some more shares in my portfolio or just invest more in my index funds."

[0:26:48.8]

DC: Yeah, we've had such an easy ride for many of the last seven years for at least five of the last seven years, it's been kind of straight up. So we forget the average intra year draw down over the past 35 years has been 14%. We get a market correction basically every year. Volatility is the norm and not the exception and people need to be reminded of that.

[0:27:13.2]

FT: "Volatility is the norm, not the exception." What's another philosophy that you live by?

[0:27:18.8]

DC: My goodness, the philosophy that I live by is trying to put first thing's first. For me, money is freedom and it's a way for me to say "no" to people and has spent more time with my family. I really try and put first thing's first and even though I'm immersed in the study of money and the psychology of money, all it does is buy me time with the people that I love and when it starts to become more than that, that's a problem.

[0:27:49.2]

FT: Tell us about one of your number one money habits Daniel? What's something that you do consciously and regularly to make sure that your money is where it needs to be?

[0:28:00.5]

DC: Yeah, so my number one money habit is, actually, chapter two of the book, I say you can't do this alone so one of the things that I do that surprises a lot of people is that I work with an investment adviser. So I'm an investment adviser myself, I write books on this stuff, I talk about it all the time and yet why do I still work with somebody who I pay to oversee my money, and the reason that I do this is because I understand that I'm just as irrational and stupid and scared and greedy as the next person.

In the book, I talk about people who work with an adviser, tend to outperform those who do it themselves by two to 3% per year and the compounding of the two to 3% per year is pretty dramatic over an investment lifetime. There's a lot of talk, I think, in sort of the blog sphere about the expenses associated with advice but I think if you get someone good, they can save you from yourself and that's the biggest value that an adviser has.

[0:29:00.4]

FT: Yes, prerequisite for my financial adviser, "You just saved me from myself." That's a good thing to put on your application. Dr. Daniel Crosby, thank you so much, before we let you go, you got to finish this sentence for us, I'm So Money because _____.

[0:29:18.1]

DC: I'm So Money because my wife and I will be welcoming our third child in just two days.

[0:29:24.4]

FT: Oh my goodness, well congratulations, what a big time for your family and we wish you all the best. Thanks so much for joining us.

[0:29:32.4]

DC: Thank you for having me.

[END]

