Rational thinking

It's time to start challenging our logic says Finance Editor Susanna Stuart

PHOTOGRAPHS **GETTY IMAGES** SUSANNA STUART IS A FINANCIAL ADVISER. A FREE DISCLOSURE STATEMENT IS AVAILABLE BY EMAILING SUSANNA@STUARTCARLYON.CO.NZ

WHY DO HUMANS make consistently dumb decisions when it comes to money? It's a question MIT (Massachusetts Institute of Technology) professor Dan Ariely has sought to answer in his latest book, *Predictably Irrational: The Hidden Forces That Shape Our Decisions* (HarperCollins, $34.99).

This is particularly relevant right now as the world's share markets have been in a nose dive, and if you've been to a property auction lately you'll know how dispiriting things have become for vendors. So why did we stop buying? What happened to the basic idea that one should buy low and sell high? Surely now is the time when anyone with some loose change should be investing.

The problem is the way we frame the decision to buy or sell. Once we get it into our heads that the markets are heading down, we seem to lose all sense of value. We can't bear the thought of buying something only to see it lose a little in value. Yet that's what happens every time we buy a new car.

The truth is investments go up and down all the time, but when they've just dropped a big amount, as they have recently, then any sound investment has more up potential than down. We just don't see it that way.

The golden rule is to invest in things you can see. One of the world's richest men, Warren Buffet, keeps investing in unsexy companies like Coca-Cola because they make stuff that people keep buying, whether or not there's a dot-com boom or a subprime mortgage blow-out. He keeps it simple. N

Before you invest

How could so many prudent people lose their shirts in the Blue Chip debacle? The sales techniques of the failed company have come under scrutiny, and provide rules for investors:

1 Ask what the underlying activity of the business is. People who invested in Blue Chip were obviously dazzled by the promised returns. But if they'd been asked, "Do you really want to be a property development speculator?" they would probably have said no.

2 Always get independent advice, and by this I mean advice from people who have nothing to do with the company you're considering investing with. This means using your own valuer, or your lawyer.

3 Work through the scenarios. An accountant or financial adviser can help you examine what would happen if, say, the market went down. They can help you assess the risks, the tax implications and your ability to simply cash up if you need to.

4 Don't rely on guarantees. No business can offer a 100% guarantee.

5 Don't scrimp on doing your homework. It's like buying a house – spend a few hundred getting a building report or you risk buying a leaky home.

Did you know…?

In the US, the Federal Deposit Insurance Corporation insures deposits in most banks and savings associations. If a bank fails, deposits are protected against the loss of up to $100,000. In New Zealand, many people aren't aware that deposits with banks are unsecured and not guaranteed by the Government. However, banks are under supervision of the Reserve Bank. Clearly it pays to be sensible by having your money suitably invested in a range of investments, rather than stand to lose by having it all in one spot.