

Do You
SABOTAGE

BETTER INVESTOR



Daniel Kahneman's radical insights may
forever change the way you invest.

YOURSELF?

BY JASON ZWEIG

Photographs by David Barry

WHEN PEOPLE ASK ME which investment thinker I've learned the most from, they expect names like Warren Buffett, Peter Lynch and John Bogle. But I always give the same answer: Daniel Kahneman. ♦ He's not a great stock picker like Buffett, a masterful fund manager like Lynch or a crusader for investors' rights like Bogle. Instead, Kahneman is a psychologist at Princeton University who studies how people estimate odds and calculate risks—the very essence of investing. To my mind, Kahneman has done more than anyone else alive to shed light on how to improve our investing judgment and manage risk intelligently. ♦ My fascination with Kahneman began

five years ago, when I heard him speak at an investing conference sponsored by Harvard. His blue-green eyes glittering behind heavy eyeglasses, Kahneman swept back and forth like a hungry owl, holding the audience of money managers transfixed. Citing research on everything from American entrepreneurs to Swedish drivers, he explained how prone humans are to “overconfidence,” or the belief that we know more than we really do. He bolstered his case with tales from his own life, confessing that he'd once underestimated by seven years how long it would take to help write a textbook. In an accent that's part French and part Israeli, he asked, “Do you know how little you know?” Under his keen gaze, those words felt like a challenge to re-examine everything I'd assumed to be true.

As soon as I returned to my office, I hunted down *Judgment Under Uncertainty*, a hefty anthology of scholarly articles Kahneman had written with his longtime research partner, Amos Tversky (who died that year). I spent the next three days in a fever of intellectual discovery, hiding out in a windowless, soundproof room where no one could interrupt me. Scribbling notes furiously, drawing arrow-strewn diagrams and sprinkling the book with exclamation points, I discovered insights and connections that had long eluded me. Why do people buy high and sell low, when they know they should do the opposite? Why do investors listen to analysts who are clearly clueless? Kahneman and Tversky had the answers.

Daniel Kahneman has done more than anyone else to explain why most of us make so many mistakes as investors—and what we can do about it.

I felt as if someone had taken the top of my skull off with a can opener and was shining a searchlight inside. What that light revealed was hardly what I'd expected: I was not the rational, sensible investor that I'd always thought I was. In many ways, I now saw, I was a dope. And that, Danny Kahneman has been teaching me ever since, is probably the single smartest thing I—or any investor—could ever figure out.

Others have been similarly enthralled. William Sharpe, the Nobel-prizewinning economist, says the findings of Kahneman and Tversky are “certainly worthy” of a Nobel. “I love their work and always have,” says Sharpe. “There's a huge amount of information in there that helps us understand how people actually make decisions.”

In this age of instantaneous information, any of us can find out almost everything there is to know about any stock. Why, then, have so many of us lately earned the worst returns of our lives? Because information is useless if we misinterpret it or let emotions warp our judgment. Kahneman's research throws us a lifeline that can save us from our own self-defeating behavior.

PIGEONS, PILOTS AND IPOs

Kahneman was born in Tel Aviv in 1934, but his French parents returned home to Paris when he was three months old. Six years later, as Kahneman was finishing first grade, the Nazis invaded France, and his family was forced to wear the yellow star that marked Jews for deportation to the death camps. His father, a research chemist, was taken away but then released because he