

in papers, and he sheepishly admits that he's never even glanced at the classic English novels his wife buys him.

In the past few years, Kahneman has shifted to measuring what makes us happy. I ask him the obvious: Does money buy happiness? "Not exactly," he says. Even as wealth has surged in recent decades, the percentage of Americans who say they're happy with their lives has remained basically the same. But money does buy happiness in one sense, Kahneman notes. The key is not how much you have, but how you spend it. "There's good evidence," he says, "that people get more pleasure from things they're not habituated to." Like what? "Flowers, feasts, vacations," he offers. "Try to spend your money on things you won't get used to or tired of."

As the ultimate authority on why most of us fail to get rich, Kahneman would seem ideally equipped to master the stock market. But when it comes to investing, he says, "I don't try to be clever at all." He largely sticks with index funds, which buy and hold a vast array of stocks. Comfortable with his limitations, he doesn't chase individual stocks or trade in and out of the market. "The idea that I could see what no one else can is an illusion," he says.

Few of us are as honest about our shortcomings as Kahneman is. Yet we can all benefit from applying his insights to our portfolios. Here are the lessons I've learned from him.

- **Distrust data.** Rather than leaping to conclusions based on scant data, look at as many numbers as possible. Don't rely just on recent performance; look at several time periods. "It doesn't take many observations to think you've spotted a trend," warns Kahneman, "and it's probably not a trend at all." Merrill Lynch, for instance, recently told investors to slash their exposure to overseas stocks since foreign returns have lately resembled those of U.S. stocks. But what if that proves to be an aberration?

- **Chill out.** The hotter an investment's recent returns are, the more skeptical you should be about its future. Remember to ask what eventually became of other similarly faddish investments. Until lately, years of easy profits had made investors much too confident. As Kahneman wryly notes: "In a rising market, enough of your bad ideas will pay off so that you'll never learn that you should have fewer ideas."

- **Anchors aweigh.** When pundits like Goldman Sachs' Abby Joseph Cohen predict where the Dow is heading, or when analysts like Morgan Stanley's Mary Meeker forecast Amazon.com's stock price, the market often moves magnetically in their direction. But don't anchor your expectations to the tea leaves of the so-called experts. At best, they're making educated guesses; at worst, they're manipulating you to make money for their own companies.

- **Use mad money.** If you can't resist the temptation to trade stocks, put the bulk of your portfolio in a broad stock-index fund; then take a little (10% tops) to "play the market" yourself. This way, you keep your hunches on the fringe,

where they belong. "It's like going to the casino with only \$200," says Kahneman. "It helps protect you from regret."

- **Step back.** In scary times like these, force yourself to look at your whole portfolio. Last year, my stake in AOL Time Warner (MONEY's parent) plunged 57% in the fourth quarter. But Kahneman has taught me to use what he calls "global framing," or looking at the sum total of everything I own. It turns out my entire portfolio was down only 8% that quarter and was flat for the year. So I didn't sell, because I didn't panic—and my 57% loser has since bounced back.

- **Stop counting.** "If owning stocks is a long-term project for you," says Kahneman, "following their changes constantly is a very, very bad idea. It's the worst possible thing you can do, because people are so sensitive to short-term losses. If you count your money every day, you'll be miserable." So I check the value of my investments a grand total of four times a year; while others agonize over what their stocks did from 1:24 p.m. to 1:37 p.m. today, I'm more concerned about where mine will be between the years 2024 and 2037.

- **Fly on autopilot.** Many of the people who loved the Nasdaq when it was at 5000 a year ago won't touch it now that it's at less than half that level. Such irrational mood swings lead people to trade too much as they veer erratically between glee and dismay. "All of us," says Kahneman, "would be better investors if we just made fewer decisions."

Luckily, there's a solution called dollar-cost averaging. Every month,

an automatic electronic transfer sweeps money out of my bank account and into index funds. I never try to predict where the market is going; I just mechanically shovel more cash into my funds each month, regardless of whether the market has been going up, down or sideways. I call this my "permanent autopilot portfolio." It gets me out of trying to guess what will happen next—a game that Kahneman has taught me I can't win.

- **Look within.** Most financial advice, especially on TV and the Internet, suggests that investing is an endless race to beat the market. Every day brings a breathless stream of bulletins about who's ahead or behind. If anyone else wins, it seems, you lose. But Kahneman's insights teach us something very different and vastly more profound: Investing isn't about beating others at their game. It's about controlling yourself at your own game. I'm not a penny poorer if someone in Dubuque beats the S&P 500 and I don't. But I can ruin my family's financial future if I lose my self-control and let my greed or fear trick me into buying high or selling low.

For each of us, risk doesn't reside only in the market. It lurks inside ourselves—in the way we misinterpret information, fool ourselves into thinking we know more than we do or overreact to the market's swings. By teaching me the paradox that the most powerful thing I can learn is how little I can ever possibly know, Danny Kahneman has set me free. **ES**

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that tracking your  
STOCKS  
DAILY is "the  
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