Big Little Choices

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The Key Wealth Institute is a team of highly experienced professionals from across wealth management, dedicated to delivering commentary and financial advice. From strategies to manage your wealth to the latest political and industry news, the Key Wealth Institute provides proactive insights to help grow your wealth.

How good planning helps us make better money decisions

Seventy years ago, New Zealand explorer Sir Edmund Hillary and Nepalese sherpa Tenzing Norgay ascended the world's tallest mountain — Mount Everest. Hillary and Norgay were the first climbers known to reach the summit successfully. Since 1953, about 6,000 people have followed in Hillary and Norgay's footsteps and reached the top. Thousands more have tried and failed. Hundreds have suffered significant injuries or lost their limbs because of frostbite. Some have lost their lives.

What differentiates those who make it to the summit (and back) from those who fall short? Quality planning and good and timely decisions.

When we set any goal — whether it's to reach the summit of Mount Everest or simply to live a healthy and prosperous life — the difference between success and failure often comes down to our decision-making process. From little choices to big decisions, the outcomes we desire are mostly within our control.

The journey to the top of Mount Everest, 29,029 feet above sea level, is treacherous. The most dangerous segment is above 26,000 feet. At this altitude, the oxygen level is too low to sustain human life for an extended period. Even the most acclimated climbers carry tanks with supplemental oxygen to survive the final stage of the ascent.

Successful climbers are meticulously prepared, technically trained and physically and mentally fit. They manage their resources judiciously, adapt to changing weather conditions, assess risks, and make prudent choices in an unforgiving environment. In other words, they have a plan that helps organize strategic decisions before the expedition. A successful plan must be based on a decision system that climbers can rely on when the unexpected happens. At 26,000 feet, the human body is physically and mentally drained. Climbers have to trust their plan and balance their instincts with rational choices.

When we think about decision-making, we often consider conscious decisions. For example, parenting, money, or health decisions are typically informed and intentional. Why and how we make decisions is an area that has been studied and researched for decades.

Academics refer to the study of decision-making as behavioral science. Renowned behavioral scientists Daniel Kahneman, Amos Tversky and Richard Thaler, all Nobel Prize laureates, contributed extensively to understanding human behavior. Kahneman and Tversky (posthumously) won the Nobel Prize for their work known as the Prospect Theory[1]. They concluded that humans are twice as motivated to avoid a loss than to pursue a comparable gain.

Thaler won a Nobel Prize for the concept of mental accounting. He argues that people value money differently and make different decisions (all else being equal), depending on where the money comes from. For example, we likely will spend lottery winnings differently from money acquired from our own earnings.

Kahneman authored a bestselling book, "Thinking Fast ... And Slow," in which he documents the years of research he and Tversky conducted on human behavior and the choices and decisions that motivate it.

Successful climbers prepare and plan their journeys. They prepare their bodies and minds for the known and unknown risks they might face. They train, prep, and test their gear. They assess weather conditions, study challenging segments of the climb and plan their campsites. However, there is a difference between being prepared and having a plan.

Preparation is about knowledge, skill, readiness, ample supplies, and assessment of known risks. Planning addresses the what-if scenarios and, more important, what decisions should be made if X occurs. In challenging environments, climbers do not have time to strategize. Planning is about predictions and probabilities — training our brains to react the right way when it matters most. In other words, planning for a variety of outcomes is the slow-thinking stage of decision-making. Being ready to make good choices at critical moments is the think-fast phase.

The pre-expedition prep and planning by climbers are no different from how we prepare and plan for our family's financial goals. We prepare by developing good money habits: savings, budgeting, managing cash flows, investing in retirement plans, and defining financial goals and priorities. We plan for uncertainties, anticipating and stress testing for challenging markets or volatility. And we consider our choices should something unexpected or untimely occur. If we find ourselves in a challenging economic environment or experience an unexpected life event, having a plan helps us make more rational decisions.

We can draw other parallels between the expedition up the world's tallest mountain and our journey to achieving financial security. During the climb, teams must manage their resources — food, energy, and oxygen — to succeed. Climbers must conserve these finite resources to last throughout the journey. This is especially critical during descent. Descent, not ascent, is the most dangerous part of the climb. At this point, fatigue, rapidly changing weather conditions, overconfidence, and oxygen deprivation make the return trip more dangerous. In fact, that's when most accidents on Mount Everest occur.

Consider the ascent of Mount Everest as the accumulation phase of your financial journey. As you climb up the mountain, you are managing and consuming resources. But, you are also conserving resources for the return trip.

Money, like oxygen or strength, is a finite resource. To make sure it lasts, we have to make smart choices — sometimes, in difficult conditions — to progress up the mountain. Decumulation is the descent stage of our financial journey. For most investors, it begins at retirement and continues over their lifetimes. If climbers deplete most of their oxygen and strength on the way up, they have no chance to return safely to base camp and may be at the mercy of other members of the expedition to share any surplus resources.

Money decisions are similar. If we do not save enough, conserve our resources, and adequately plan for the what-ifs, we risk prematurely depleting what we need to live a long and healthy life. When making sound money decisions, investors must accept uncertainties, assess risks and priorities, and be prepared to react to life events. Those moments of hesitation and uncertainty at 26,000 feet above sea level are when we are most likely to overreact and make irrational decisions.

Preparation and planning are foundational to good decision-making. But we are human. And humans have biases. Planning, as a decision system, can help us develop better habits and limit the influence of bias on our decisions.

To better manage our reliance on bias, here are three cognitive biases that are common to money decisions and to the quest to conquer Mount Everest:

Anchoring

Coincidentally, this first cognitive bias includes the word “anchor,” which rock climbers use to attach and secure ropes during the climb. But in psychology, anchoring bias refers to humans relying too much on the initial piece of information, or anchor, when making a decision.

For example, assume we purchase a stock at $50 per share. A few months later, the price of that stock drops to $40. From a risk-assessment standpoint, we will refer to our purchase price of $50 to determine the downside risk of the stock. And if our only point of reference is that initial price, we are susceptible to making an irrational decision — selling too early or too late. But the $50 price may not tell us much about the company’s actual value or upside/downside potential. The decline from $50 to $40 may be temporary. Or, perhaps, even at $40, the stock is overpriced. We need more information, research, and conviction that the purchase aligns with our plan to make a better choice.

Present bias

Now matters more than later. Emotions today matter more than potential benefits in the future. This one is real. Satisfaction with something we can acquire and experience today is powerful, even if, deep down, we know there will be consequences of that decision in the future.

Present bias is most common when it comes to spend-versus-save decisions. In an experiment documented by Irrational Labs[2], participants were given a choice: Receive $100 today or $120 in 30 days. Most opted for $100 today, even though they would have gained a 20% profit by waiting just one month. In the same experiment, another group was given a different choice: Receive $100 in 12 months or $120 in 13 months. This time, the responses were overwhelmingly in favor of $120 in 13 months. Why the reversal? Time. Twelve or 13 months is all the same if we have to wait. But offer us $100 today and we are all in.

Confirmation bias

This is a tendency to search for, interpret, and put greater emphasis on information that confirms our existing beliefs. In the recent history of the financial markets, cryptocurrencies are a perfect example of confirmation bias (though other biases played a role in the appreciation and, later, rapid depreciation of crypto).

Diehard crypto investors see it as a currency that will eventually replace physical currencies for payments. Their arguments are rooted in their belief that a decentralized money exchange in the digital age is all but inevitable. Any research or position that argues against this belief — even if well-researched and argued — is dismissed. At least in the short term, crypto investors are finding the investment extremely volatile. The future of digital currency may still play out as those investors imagined. But it is irresponsible and irrational to rely only on research and analysis that agrees with that future.

Climbers are susceptible to the same cognitive biases. For example, it is common for teams to maintain regular communication with base camp and other teams on the mountain. Mistakes happen when climbers anchor their decisions to a single source or dismiss information that offers contradictory reports. Due to weather forecasts, some teams only get one shot to reach the summit. They may be tempted to take a chance even though new risks may have emerged. Present bias — the opportunity to achieve the ultimate goal now — can cloud a climber's judgment and put lives at risk.

Good decision-making starts with extensive preparation and planning. Our expedition to financial independence can be successful if we build good habits and acknowledge our biases. In future articles in this series, we will explore other cognitive biases that affect our choices. Building a plan that documents our goals and priorities and accounts for the unknown risks that may lie ahead is the most important action we can take to become better money decision-makers.

A financial plan is our expedition plan, which will guide us to the top and back, through the highs and lows in life. With it, we can reach the summit and return to camp. Without it, we may find ourselves stranded, with no oxygen and drained of energy, in the unforgiving environment of the Himalayas.

For more information, please contact your advisor.

About the Author

Tom serves as the National Director of Wealth Planning at Key Wealth Management, where he is at the forefront of engagement, education, and delivery of comprehensive wealth planning strategies across the firm. In addition, he leads the Key Wealth Institute, producing insightful thought leadership articles and papers on wealth management topics. With a dedication to helping clients make well-informed financial decisions, Tom's team emphasizes aligning wealth with intent and promoting improved financial outcomes.

Before his tenure at KeyBank, Tom held a significant role at JPMorgan Wealth Management as the head of Goals-Based Planning. His experience also includes advising families, business owners, and corporate executives at JPMorgan Private Bank. With over two decades in the wealth management sector, Tom brings unparalleled expertise and insight.

Tom holds a B.A. degree in International Economics from DePaul University in Chicago, IL, and proudly earned his Certified Financial Planner (CFP®) designation in 2005. An active contributor to industry initiatives, he collaborates with the CFP® Board, firms and academic institutions.

[1] "Thinking Fast and Slow" by Daniel Kahneman

[2] Irrational Labs research, https://irrationallabs.com/blog/cognitive-biases-and-academic-research/

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