

Cocaine Brain

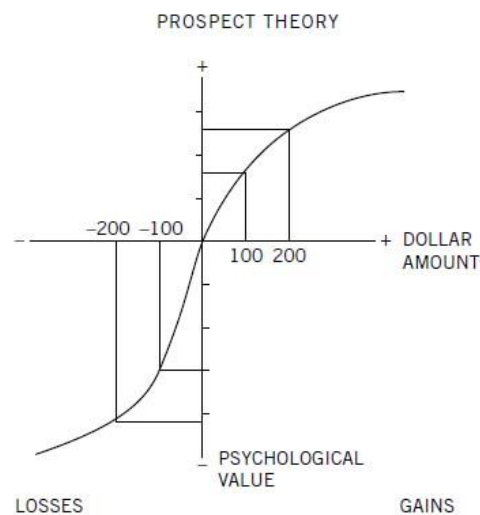
January 23, 2016

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Research in neuroscience reveals that our brains are pattern seeking and are designed to perceive trends even when none exist. After an event occurs just two or three times in a row, regions of the human brain called the anterior cingulate and nucleus accumbens automatically anticipate that it will happen again. If it does repeat, the natural chemical dopamine is released which floods your brain with soft euphoria. This intoxicating prospect of making money can arouse the same parts of the brain that are simulated by drugs – our ‘cocaine brain’.

On the other hand, when stocks drop, that financial loss triggers the amygdala part of the brain that processes fear and anxiety and generates the famous ‘fight or flight’ response that is common to all animals. Our reptilian instincts are so ingrained in us that we can’t help but feel fearful when stock prices are plunging, just as we can’t avoid keeping our heart rate from rising during a fire alarm.

This has important implications in investing. Psychologists Daniel Kahneman and Amos Tversky have shown that people exhibit loss aversion. They concluded that losses were 2.5 times as undesirable as equivalent gains were desirable. This power asymmetry between the power of positive and negative experiences has an evolutionary history. Organisms that treat threats as more urgent than opportunities have a better chance to survive and reproduce.



Source: *Thinking Fast and Slow* by Daniel Kahneman