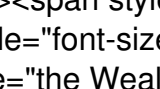


# Greed

Written by John D. Buerger, CFP

Monday, 26 April 2010 13:25 - Last Updated Tuesday, 24 August 2010 04:50

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 In light of the fact that Goldman Sachs executives are appearing in front of Congress today (10 days after the SEC filed charges against the firm for fraud), I thought it would be good to revisit the concept of Greed. But first a question ...

Where do you see yourself fitting in to this landscape?

1) At one end of the spectrum is a place where you are completely independent and free, but you are also completely responsible for whatever you have or don't have - there are no handouts.

2) At the other end of the spectrum you have no liberties, but you are completely secure knowing that you will be provided for - at least in some minimalistic way - and no better or worse than your neighbor.

In one you have complete control of the process but no control over the outcome. In the other you have no control over the process but will end up with a certain and somewhat-below-average outcome.

Where would you prefer to see yourself within that spectrum? There is no "right" or "wrong" answer to that question. Where you fit on the spectrum is where you fit ... however, there are two reasons why your answer may not be in alignment with what is best for you: (1) it is likely that you do not understand the parameters of the question and (2) your judgment of your risk tolerance is skewed by recent experience.

**Misunderstanding the Parameters**

The Liberty-Security spectrum is subject to interpretation. My sense of liberty is likely very different from yours. Where people are truly mis-informed, however, is that they think the results are the same no matter where on the Liberty-Security spectrum we are as a society. If you are completely independent and free, the result set is everything from total failure to incredible success. There is an average of all these results which is what society in general realizes. Some people get more, some get less but the average stays fixed at some point. If you move toward the "Security" side of the spectrum, what happens to the results for you personally, and what happens to the average results for society?

**Security Comes With a Price**

In the world of personal finance, security always comes with a price. An insured product (an annuity, for example) always generates a lower rate of return than the equivalent uninsured product (investment account). You sacrifice overall returns for the safety of the insurance company guarantee on the contract. If you buy a CD, you get a fixed (and crappy) rate locked in, but the account is safe and insured. You pay for that safety with the lower overall rate. The same is true as you move to the "safer" side of the Liberty-Security spectrum. While the below average effort may see better results, the above average effort will see considerably lower results. The average results for society have to be less. Security ALWAYS comes with a price even at the societal level. So as you move from Liberty to Security, you also have to lower your expectations for overall average results.

I don't think many of us recognize that ... and it sure seems like the security being offered by government programs do not acknowledge this universal law. They imply that you can get something for nothing, which we all know cognitively isn't possible. However, our emotional brain wants to believe that it IS true and we fall for the lie hook, line and sinker.

**Impaired Judgment**

The second challenge you face is that human judgment of risk tolerance is heavily skewed by recent experience. I can go through a risk tolerance survey with an investment client and they may say they could tolerate a 20% loss in their portfolio. This happened dozens of times before the 2008 meltdown. Then, when the market cratered 38% and they were down 22% (a well diversified portfolio does much better in a down market), many of them were asking to reconsider their risk tolerance responses.

When times are good, we THINK we can handle more challenges than we really can tolerate. When times are really tough, our emotional brain takes over and seeks out safety at any cost. If you have government offering safety at "no perceived cost" (government bailouts for example), it's easy to see how people can be suckered into making poor decisions. Eventually the costs do become apparent, but not before it's too late.





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adverse consequences. "Command and Control" systems where one person dictates to others what to do are at best inefficient and at worst a ticking time bomb of resentment. Just think how you felt when your parents told you to clean your room "because I said so." There are plenty of better ways to get the same end result.

Financial planners are slowly learning that they cannot dictate to their clients what to do with their money. It doesn't work. The first hint of trouble throws the client into "reaction" mode. They either go on a retail-therapy addiction binge or stick their head in the dirt and try to ignore everything. The better way is to provide a framework the client can use to make better decisions that are more in alignment with what is important to them.

(2) Greed is human nature. It is present in every one of us ... including the regulator who will continue to "fix" the regulations to satisfy his or her own greed. In essence what happens is that the greed is transferred from the regulated to the regulator. We used to call this a "power trip" when I was growing up. Human history is riddled with despots who were granted more and more power to "fix" things until it was too late.

Power Corrupts. Absolute Power Corrupts Absolutely.

### **A Better Solution**

Our country's founding fathers had a much better solution. Create a few simple laws that set the boundaries. Define the basic human rights (life, liberty and the pursuit of happiness) that are protected by those laws and the government. Enumerate the allowable actions of government and make everything else off limits. Then encourage the citizens to realize as much as they can - essentially to channel their greed - as long as they do not infringe

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on the rights of others.

If a person wants to do nothing and create nothing, they end up with nothing. If they are really ambitious (and greedy) they can strive to have a lot and odds are they will. There will be winners and losers. There will be up cycles and down cycles because that is a part of human nature and human hard-wiring (herd mentality, social proof, recency bias, etc). In short, there will be good times and bad ... but the AVERAGE result will be the best possible because we won't be wasting a lot of resources on security - Security which always comes with a price.

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