

Why Is It So Hard to Save? Blame the Brain

To invest as you should, you need to get past your gray matter's spendthrift ways



▶ **Slow and steady wins the race,** but a bird in the hand is worth two in the bush. Those dueling proverbs sum up the investing mind. When you imagine choosing between making a quick buck or growing rich later, you know the right answer: Be patient and hold out for the bigger gain. But as soon as you face a real rather than an imaginary choice, the fast money seems irresistible.

New discoveries in neuroscience labs are helping to explain why it's so hard to resist the allure of instant gratification. It turns out that your brain is much more aroused by \$1 today than by \$1 tomorrow. And \$1 six months from now barely registers. Only the promise of a much bigger reward later can fire up your brain the way an immediate score does. No wonder it's hard to save instead of spend and, when you do save, to think long term; the average holding period for a stock, among individual and professional investors alike, is just over 11 months. And the temptation to buy dotcom stocks in 1999, energy stocks in 2005, real estate in 2006, emerging markets in 2007 or gold right now—what's hot when it's hot—is overpowering for many people, no matter how often they've been burned before.

A SIP NOW OR A SLURP LATER?

Recent experiments conducted independently by three teams of researchers at leading universities have focused on the battle in the brain between now and later. Tracking people's choices and their brain activity, one group tested whether college kids would rather have a sip of fruit juice soon or a slurp later. They also tracked how folks decided between Amazon.com gift certificates redeemable the same day for a small amount and those redeemable up to four weeks later for a larger amount.

A second team offered people the choice between \$20 immediately and an array of alternatives ranging from \$20.25 six hours later to \$110 six months later. And a third group measured how individuals responded to the choice between various dollar amounts today and an extra 5% to 30% up to six months later.

"When our emotions are charged, we have a hard time waiting for a reward," says Carnegie Mellon University's George Loewenstein, one of the first study's authors. Even the chance of getting a slightly bigger reward tomorrow doesn't have the same stimulating effect on your brain as a gain today does.

It's all downhill from there. A gain the

day after tomorrow carries even less of an emotional kick, and so on. In fact, to the typical person, \$20 now is better than \$23 three weeks from now, \$40 three months from now or \$47 six months from now, according to the second study, led by a pair of New York University researchers (see the chart below). In short, for your brain to be willing to wait a mere three weeks for a higher payout, that \$20 would have to grow at an annualized rate of roughly 4,800%.

Rational? Hardly. But evolutionwise, the response makes sense. In our hunter-gatherer days we often faced scarcity. And when we're *really* hungry, a future feast has to be huge to justify choosing it over eating now.

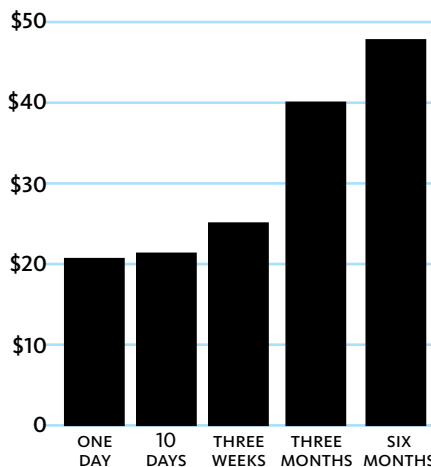
So are we moderns doomed to save and invest like cavemen? Not necessarily. Knowing that you operate in what NYU's Paul Glimcher calls "as soon as possible" mode is the first step to making better financial decisions. Willpower and good intentions, though, aren't enough. You need help. Here's what to do:

▶ **Lock in for later.** Saving now is harder than planning to save later. So commit yourself to doing the right thing a year from today. Want to raise your 401(k) contribution? Use calendar software to mark the distant date when you'll take action—and send an e-mail to a small group of friends now and on that day reminding them that you have committed.

▶ **Don't take your lumps.** When you change jobs, it's tempting to take the money in your old 401(k) as a lump sum instead of rolling it into a new plan or an IRA, especially if you're decades from

TODAY \$20 IS EXCITING. TOMORROW? YAWN.

Given a choice between \$20 today and a larger sum later, research subjects take the money now unless the future rewards get absurdly large.



SOURCE: Paul Glimcher and Joseph Kable, New York University.



retirement. So whenever you're starting a job hunt, pledge in writing to a friend that you will roll over the retirement account. Likewise, if you are older and are fortunate enough to have built up a sizable pension benefit, pledge that instead of taking a lump sum when you're eligible, you will string your pension out over many years as an annuity. Have that commitment witnessed by friends or family members younger than you so they will

likely be around when you put away the work shoes.

Similarly, when you're investing your savings, you need to resist the temptation to simply go for whatever looks as if it will provide a quick return. Take these steps:

➤ **Answer two big questions.** Why—other than a rising stock price—should I invest in this business? Do I have any reason to think that I know more about this company than whoever sells me the stock?

➤ **Sleep on it.** If putting money into a hot mutual fund is really a good idea, it'll still be one tomorrow. Waiting until the next morning won't cost you much profit, but letting your brain's anticipation circuitry cool down overnight could save you from an ill-timed bet. And you'll be richer for your patience. \$

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Money70 OUR LIST OF RECOMMENDED MUTUAL FUNDS AND ETFs

The stock market had a tough run in the month ended Jan. 10, and so did most MONEY 70 stock funds. Worst for the period was **Cohen & Steers Realty**, which declined 10.7% as commercial real estate got battered. **Vanguard REIT Index**, another real estate fund, took a 9.8% hit. Among stock funds, emerging markets held up best. **T. Rowe Price Emerging Markets** eked out a 0.6% gain. Bond funds had a good month, led by **Harbor Bond**, up 2.6%.

FUND (TICKER)	TOTAL RETURN			EXPENSES (AS % OF ASSETS) ²	PHONE NUMBER (800)
	1 MO.	1 YR.	3 YRS. ¹		
Large-Cap					
American Funds Amcap (AMCPX) ³	-3.9	2.2	7.3	0.64	421-0180
Am. Funds Am. Mutual (AMRMX) ³	-4.3	0.4	7.9	0.55	421-0180
Fidelity Spartan 500 Index (FSMKX)	-4.4	1.6	8.4	0.10	343-3548
Fidelity Spartan Total Market (FSTMX)	-4.8	1.1	9.0	0.10	343-3548
FMI Large Cap (FMIHX)	-4.3	0.4	9.9	1.00	811-5311
iShares S&P 500 Index (IVV)	-4.4	1.6	8.4	0.09	474-2737
Jensen (JENSX)	-4.6	2.4	6.1	0.85	992-4144
Matrix Advisors Value (MAVFX)	-5.2	-4.6	5.7	0.99	366-6223
Selected American (SLASX)	-4.2	1.1	9.3	0.90	243-1575
Sound Shore (SSHFX)	-2.8	0.4	8.8	0.92	551-1980
T. Rowe Price B/C Growth (TRBCX)	-4.2	6.8	9.4	0.82	638-5660
T. Rowe Price Equity Income (PRFDX)	-4.1	0.3	8.6	0.69	638-5660
Vanguard 500 Index (VFINX)	-4.5	1.5	8.4	0.18	851-4999
Vanguard Total Stock Market (VTSMX)	-4.9	1.0	8.8	0.18	851-4999
Vanguard Total Stock Market ETF (VTI)	-4.8	1.0	8.9	0.07	851-4999
Vanguard Windsor II (VWNFX)	-4.6	0.0	8.8	0.32	851-4999
Midcap					
Fairholme (FAIRX)	-3.0	11.5	13.9	1.00	202-2263 ¹
FAM Value (FAMVX)	-6.3	-6.5	3.8	1.18	932-3271
Fidelity Value (FDVLX)	-7.7	-4.7	9.3	0.67	343-3548
FPA Perennial (FPPFX) ⁵	-7.0	0.7	6.6	0.92	982-4372
Janus Mid Cap Value (JMCVX)	-3.8	3.5	11.2	0.93	525-3713
Meridian Growth (MERDX)	-7.2	-2.8	6.8	0.84	446-6662
Primecap Odyssey Agg. Gro. (POAGX)	-8.4	-9.0	9.6	0.99	729-2307
Vanguard Mid-Cap ETF (VO)	-6.5	-1.0	10.5	0.12	851-4999
Vanguard Mid-Cap Index (VIMSX)	-6.5	-1.1	10.4	0.22	851-4999
Multicap					
Bridgeway Agg. Inv. 2 (BRAIX)	-5.9	23.5	17.3	1.21	661-3550
Muhlenkamp (MUHLX)	-5.7	-12.1	-0.4	1.04	860-3863
Weitz Hickory (WEHIX)	-5.6	-19.1	1.1	1.20	304-9745
Small-Cap					
Bridgeway Small Cap Value (BRVX)	-6.6	-1.3	11.4	0.83	661-3550
Royce Pennsylvania Mutual (PENNIX)	-5.9	-3.1	9.3	0.87	221-4268
Royce Value Plus (RYVPX)	-4.6	-2.1	11.8	1.26	221-4268
T. Rowe Price New Horizons (PRNHX)	-4.9	0.7	8.2	0.83	638-5660
Vanguard Small-Cap ETF (VB)	-7.0	-5.3	7.8	0.09	851-4999
Vanguard Small-Cap Index (NAESX)	-7.0	-5.4	7.7	0.23	851-4999
Specialty					
Cohen & Steers Realty (CSRSX)	-10.7	-26.7	8.2	0.96	330-7348
iShares Dow Jones Select Div. (DVI)	-5.8	-8.5	5.3	0.40	474-2737

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	1 MO.	1 YR.	3 YRS. ¹		
Specialty continued					
iShares S&P GSSI Nat. Res. Index (IGE)	0.1	41.3	28.0	0.48	474-2737
Third Ave. Real Estate Value (TAREX)	-8.3	-14.4	9.2	1.11	443-1021
T. Rowe Price New Era (PRNEX)	-1.1	45.4	28.6	0.67	638-5660
Vanguard REIT ETF (VNQ)	-9.8	-23.9	8.2	0.11	851-4999
Vanguard REIT Index (VGSIX)	-9.8	-24.0	8.1	0.21	851-4999
Foreign					
Am. Funds EuroPacific Gro. (AEPGX) ³	-2.2	18.8	21.1	0.75	421-0180
American Funds New World (NEWFX) ³	-0.7	34.7	29.9	0.99	421-0180
Artisan International (ARTIX)	-4.0	18.3	20.3	1.20	344-1770
Dodge & Cox International Stock (DODFX)	-4.2	10.1	18.5	0.66	621-3979
Fidelity Spartan International (FSIIX)	-4.2	9.4	16.7	0.09*	343-3548
Oakmark International (OAKIX)	-6.2	-4.1	12.8	1.05	625-6275
Third Avenue International Value (TAVIX)	-2.9	2.4	12.1	1.45	443-1021
T. Rowe Price Emerging Markets (PRMSX)	0.6	47.4	38.8	1.20	638-5660
T. Rowe Price Intl. Discovery (PRIDX)	-2.8	14.3	23.2	1.21	638-5660
Vanguard Emerging Markets ETF (VWVO)	-1.3	43.7	N.A.	0.29	851-4999
Vanguard Emer. Markets Stock (VEIEX)	-1.3	43.5	34.9	0.41	851-4999
Vanguard Europe Pacific (VEA)	-4.2	N.A.	N.A.	0.12	851-4999
Vanguard FTSE All-World ex-U.S. (VEU)	-3.3	N.A.	N.A.	0.24	851-4999
Vanguard International Growth (VWIGX)	-3.7	14.2	18.7	0.51	851-4999
Vanguard Total Intl. Stock (VGTGX)	-3.7	14.8	19.3	0.32	851-4999
Bond					
American Funds American H/I (AHITX) ⁷	-1.7	-0.7	5.3	0.66	421-0180
Dodge & Cox Income (DODIX)	0.8	4.7	4.0	0.44	621-3979
FPA New Income (FPNIX) ⁸	0.8	6.5	4.3	0.62	982-4372
Harbor Bond (HABDX)	2.6	10.2	5.5	0.56	422-1050
iShares Lehman TIPS Bond (TIP)	2.4	13.2	5.1	0.20	474-2737
T. Rowe Price International Bond (RPIBX)	2.1	14.0	3.7	0.84	638-5660
Vanguard Infl.-Pro. Securities (VIPSX)	2.3	13.1	5.1	0.20	851-4999
Vanguard Intermediate-Term T/E (VWITX)	1.7	4.9	3.8	0.16	851-4999
Vanguard Short-Term Bond (VBISX)	1.3	7.9	4.5	0.18	851-4999
Vanguard Short-Term Bond ETF (BSV)	1.3	N.A.	N.A.	0.09	851-4999
Vanguard Total Bond Market (VBMFX)	1.7	7.6	4.7	0.20	851-4999
Vanguard Total Bond Market ETF (BND)	1.7	N.A.	N.A.	0.09	851-4999
Target-Retirement					
T. Rowe Price Retirement (STOCK/BOND ALLOCATION)					638-5660
2005 Fund (55%/45%) (TRRF)	-1.7	4.9	8.0	0.60	
2020 Fund (80%/20%) (TRRBX)	-3.1	3.5	9.5	0.69	
Vanguard Target Retirement					851-4999
2025 Fund (81%/19%) (VTTVX)	-3.2	4.7	8.4	0.21	
2035 Fund (90%/10%) (VTTX)	-4.0	4.1	9.4	0.21	

NOTES: As of Jan 10. N.A.: Not available. Load funds are included for those who prefer to use a broker. ¹Annualized. ²Audited and annualized figures except on Fidelity. ³75% sales load. ⁴Area code is 866. ⁵25% sales load. ⁶Includes a waiver. ⁷375% sales load. ⁸350% sales load. SOURCES: Lipper, New York, 877-955-4773; the fund companies.

