

Morgan Housel

**The Psychology of
Money: Timeless Lessons
on Wealth, Greed, and
Happiness**

Made by Blinkist



These key insights in blinks were written by a team of experts at Blinkist. We screen the world of nonfiction to choose the very best books. Then, we read them deeply and transform them into this concise format that brings you the most inspiring ideas from the text.

Maybe these blinks will inspire you to dig deeper, or maybe they're enough to start you thinking and then on to something new. However you read blinks, we hope they help you become an even brighter you.

What's in it for me? Understand the psychology behind financial decisions.

How does the stock market work? When's the best time to buy or dump assets? And how much do you need to save every year to retire by a certain age?

These are the kinds of questions that dominate discussions of personal finance. There's often something important left out of the equation, however. This is the *human factor* – in other words, the relationship between real people and their money.

Morgan Housel argues that this factor is key to understanding financial decision-making. If you want to know why people bury themselves in debt or squander fortunes, you don't need to study interest rates – you need to delve into the all-too-human history of envy, greed, and optimism. And that's precisely what we'll be doing in the following blinks.

Along the way, you'll also learn

- how personal experiences shape investment strategies;
- why finding a single Picasso might mean acquiring 99 duds; and

- how envy makes investors risk everything they already have.

Everyone has their own experience of the economy and money.

The story of the Great Depression is well-known.

After a disastrous stock market crash in 1929, the global economy entered a decade of sustained decline.

In the United States, the “roaring twenties” came to an abrupt halt. Businesses folded, families lost their farms and homes, and hard-earned savings disappeared into thin air. Poverty and joblessness

skyrocketed, while faith that tomorrow would be better than yesterday plummeted.

Today, this version of events has become the standard narrative. That stands to reason – it does, after all, describe the experience of millions of Americans. But it also leaves something important out of the picture.

The key message in this blink is: Everyone has their own experience of the economy and money.

When John F. Kennedy ran for president in 1960, he was asked about his experience of the

Great Depression. His answer surprised many voters.

The Kennedys, he said, were already wealthy in 1929. And over the next ten years, their fortune wasn't wiped out – it actually *grew*. By 1939, the family had more servants and lived in a bigger house than it had at the start of the decade. It was only when he went to Harvard and read about the Depression that he realized how badly many of his fellow citizens had suffered.

Not all Americans, it turned out, had been in the same boat.

Kennedy wanted to change that, which is partly how he

convinced voters that he wasn't just an out-of-touch elitist, but a worthy president. But it's not only the rich and the poor who have contrasting experiences of economic life – we all do.

The son of an unemployed farmhand and the son of a successful Manhattan stockbroker don't just come from different walks of life – they also learn profoundly different lessons about things like risk and reward when it comes to money. But, as we'll see later on, the same applies to equally well-off people depending on their individual life experiences.

For example, a wealthy individual who grew up during periods of high inflation will have a different financial worldview than a similarly wealthy person who's only ever experienced stable prices. The resulting lessons of these different perspectives shape what we do with money.

We all like to think we know how the world works, but we usually only experience a small sliver of that reality. And that's the first thing to understand when it comes to the psychology of money: we know less than we'd like to think we do.

Personal experience drives financial decision-making.

When economists model financial behavior, they often rely on a convenient fiction – rational individuals who make self-interested decisions that maximize their returns.

Reality, of course, is a bit messier than this neat idea. Consider, for example, the lottery. The average low-income household in the United States spends \$411 on lotto tickets every year. At the same time, around 40 percent of all households struggle to find

\$400 in an emergency.

Unsurprisingly, this 40 percent is made up of the same low-income households who spend just over \$400 on lottery tickets.

Is this behavior rational? Hardly. But it's not illogical, either. If you're living from one paycheck to the next, you're unlikely to have enough money for essentials, let alone luxuries like vacations. Playing the lottery is a long shot, but it beats the alternative – not having *any* shot at getting the good stuff wealthier folks take for granted.

**The key message in this blink is:
Personal experience drives
financial decision-making.**

These kinds of irrational calls are more common than you might think. Take it from a 2006 study by economists Ulrike Malmendier and Stefan Nagel. They combed through 50 years of data compiled by the Survey of Consumer Finances – a long-running research project that examines what Americans do with their money. Malmendier and Nagel wanted to find out what determines how people invest their money.

Their answer? What the economy was doing when the investors were young adults. Personal history, in other words, determines our attitude to risk. Like buying lotto tickets, this isn't the kind of rationality found in economics textbooks, but it *is* intuitively logical.

If inflation was high between investors' late teens and early twenties, for example, they were highly unlikely to invest in bonds later in life. If inflation was low during these formative years, by contrast, investors were happy to continue to put their money into bonds as they grew older –

no matter if inflation grew along the way.

A similar pattern holds for stocks. If the stock market was doing well in early adulthood, investors went on to invest in it; if it was weak at the same age, they avoided it.

Say you were born in 1970. Between your mid-teens and early twenties, the S&P 500 increased ten-fold. Anyone who put their money into companies listed in that stock made a killing. People born in 1950 had a very different experience of the market, which was pretty much dormant during this period in

their lives. Vitally, decisions to invest or not didn't change even when the market itself did, suggesting that real-world evidence failed to change gut decisions formed early on in life.

The economic concepts we use today are still historical infants.

A toy poodle doesn't look much like its wild ancestors, who, in turn, weren't all too different from wolves.

This shouldn't surprise us – today's dog breeds have a ten-thousand-year history of domestication behind them. And yet dog owners *are* often surprised at the instinctual, bloodthirsty responses of their pets when they spot a squirrel or a cat. Ten millennia, it turns out, haven't completely

eradicated these deep-rooted wild traits.

What does the domestication of dogs have to do with the psychology of money, though? Quite a lot, actually.

The key message in this blink is: The economic concepts we use today are still historical infants.

Why are so many of us so bad at handling money? One answer is that it's pretty new in the grand scheme of things.

The first currency was only issued around 600 BC, when King Alyattes of Lydia – an Iron-

Age kingdom in today's Turkey – minted his own coins. And that's nothing compared to more complex economic concepts.

Take retirement. Before the Second World War, most Americans worked until they died. Life expectancy was lower back then, of course – and even then, half of all men above the age of 65 still participated in the labor market in the 1940s.

Things started changing with the introduction of Social Security after World War II, but retirement remained an unattainable ideal for most American workers until the

1980s – the decade in which the average monthly Social Security check rose above \$1,000, adjusted for inflation. Before that, only a privileged minority could afford to quit work in their mid-sixties.

That means that one of the most basic economic concepts we use in today's world is less than two generations old. The 401(k) – the principle method of funding retirement – didn't even exist until 1978, while the Roth IRA retirement scheme was only introduced in 1998!

Other key ideas and practices aren't much older. Hedge funds

only really took off a quarter of a century ago, and index funds are just 50 years old. Even consumer debt like mortgages, car loans, and credit cards – one of the primary drivers of economic growth in the United States – only became commonplace after the GI Bill made it easier for average Americans to borrow money in 1944.

If we're bad at financial planning and decision-making, it's not because we're crazy – it's because we're greenhorns!

Luck plays a bigger role in financial successes than you might think.

A couple of years back, the author asked the Nobel Prize-winning economist Robert Schiller what he'd most like to know about investing that can't be fully known. Schiller's answer: the "exact role of luck in successful outcomes."

Luck is a tricky topic. Few investors and entrepreneurs would deny that it plays a role in theory, but it's hard to quantify the extent to which it's responsible for one firm

prospering – and another failing. We also tend to think that it's rude to attribute others' successes to blind chance. As a result, we often end up ignoring the role of luck when it comes to financial decision-making. That's a mistake.

Here's the key message: Luck plays a bigger role in financial successes than you might think.

According to the economist Bhashkar Mazumder, the income of two siblings is more closely correlated than either height or weight. Put differently, if your brother is rich and tall, you're

more likely to be rich than you are to be tall.

It's easy enough to explain this correlation. Siblings from the same household are likely to enjoy the same privileges and opportunities. Parents who send one child to a good school usually do the same for his brother. Find a pair of rich brothers, though, and you'll find two people who don't believe that Mazumder's study applies to their family.

That's down to human psychology. We typically either underestimate or overestimate the role of luck in outcomes. If

we do well, it's because we worked hard; if we fail, it's because we were unlucky. If others fail, though, we aren't nearly as generous. In those cases, we don't attribute failure to bad luck but to character flaws like laziness or shortsightedness.

Our culture, which is obsessed with success, isn't much help here, unfortunately. *Forbes* doesn't celebrate brilliant investors who went broke because they were unlucky and the market took a sudden nosedive. It *does* celebrate second-rate or reckless

investors who got lucky and made a fortune, however.

That leaves us in a pickle. When it comes to money, we don't just need to figure out what works and what doesn't – we also need a way of building randomness into our models. We might not be able to fulfill Schiller's dream and account for the “exact role” of chance, but – as we'll see – we can get a handle on luck.

“Not all success is due to hard work, and not all poverty is due to laziness. Keep this in mind when judging people, including yourself.”

Focusing on broad patterns rather than specific cases can help you make better calls.

Bill Gates once quipped that success is a lousy teacher.

As Gates sees it, success tricks smart people into overlooking the role of luck, which in turn makes them think that they can't lose. Paradoxically, that's a pretty surefire way of ensuring that you *do* lose.

So how should you build chance and luck into your financial behavior? Well, here's what you shouldn't do: obsess over the

examples of specific individuals. When we study highly successful people, we usually end up picking outliers – the billionaires who've changed the way the world works – and that can lead us astray.

The key message in this blink is: Focusing on broad patterns rather than specific cases can help you make better calls.

Take John D. Rockefeller, one of the most successful entrepreneurs in history. When he started building his petroleum industry, he faced a problem. The laws of the United States didn't permit him to do

what he wanted to do. His solution was simple – ignore them. His disregard for legal conventions was so great, in fact, that one judge said his business behaved “no better than a common thief.”

Rockefeller’s success shapes the way we think about this behavior. Looking back, it’s easy to celebrate his vision and say that he refused to let outdated laws stand in the way of innovation. But what if he’d failed – would we still think that Rockefeller’s example is one we should follow? Probably not. At best, we’d see him as an

unsuccessful criminal who taught us what *not* to do.

But when you get down to it, the difference between these two outcomes is luck. A couple of different verdicts here and there, or perhaps a change in the political climate, might have altered Rockefeller's fortunes.

More importantly, good luck is all but impossible to emulate. Even if you mimic every career step of someone like Warren Buffett, you can't ensure the dice will fall the same way for you as they did for him.

So here's the alternative: stick to analyzing *patterns* of success and failure. The more common a pattern, the more likely that it's applicable to your life and financial decisions. Study after study, for example, shows that people who control the structure of their days are happier with their work than those who don't. Unlike the few cases of larger-than-life outliers, that's a broad observation you can act on right now.

Envy can make you reckless.

Capitalism is great at two things – generating wealth and envy.

Take a rookie baseball player who makes \$500,000 a year. By any reasonable standard, he's rich. But say he plays on the same team as a superstar like Mike Trout, who makes \$36 million a year – suddenly, he's not happy with what he earns. He wants what others have.

Meanwhile, high earners like Trout compare themselves to those who earn even more. To make it onto the list of

America's top-ten highest-paid hedge fund managers in 2018, for example, you had to have earned at least \$340 million that year. Even Trout is small fry by *that* standard.

In capitalist terms, there's nothing *morally* wrong with envy. But there is a *practical* problem.

**The key message in this blink is:
Envy can make you reckless.**

When is enough enough? Just ask Rajat Gupta.

Born in a slum in Kolkata, India, Gupta worked his way up the

corporate ladder to become the CEO of management consulting firm McKinsey. When he retired in 2007, he was worth \$100 million.

He could have done anything. But Gupta was envious. He wanted to be a billionaire.

In 2008, Gupta – a member of the board of directors at Goldman Sachs – learned that Warren Buffett was about to invest \$5 billion to keep the firm afloat during the financial crisis. Sixteen seconds after hearing this news on a conference call, long before it was made public, Gupta dialed the number of a

hedge fund manager and bought 175,000 shares of Goldman Sachs.

This was insider trading and strictly illegal. Gupta didn't care – he'd just made an easy \$1 million. By the time prosecutors caught up with him, he'd racked up \$17 million in a string of dodgy deals. It hadn't made him a billionaire, but it was enough to earn him a hefty prison sentence.

The moral of this story? Envy drives bad calls, and the cost of those calls is a lot higher than the gains you stand to make. Think of it this way: If you have

an insatiable appetite, you'll eat until you're sick. But throwing up is a lot worse than any meal is good, so you don't do that. Leaving opportunities on the table doesn't necessarily mean you're missing out – it's often recognition that trying to devour everything will push you to the point of regret.

In other words, don't be Rajat Gupta!

*“Life isn’t any fun without
a sense of enough.
Happiness, as it’s said, is
just results minus
expectations.”*

Amassing a fortune is easier than keeping hold of it.

There were few better stock market traders in early twentieth-century America than Jesse Livermore. Born in 1877, he helped build Wall Street. By the age of 30, he was worth \$100 million in today's dollars.

Just before the crash of 1929, Livermore made the best decision of his career: he took a short position and bet that stocks would decline. Sure enough, the market lost one third of its total value. While fortunes were liquidated and

news spread of bankrupt investors leaping from office windows, Livermore returned home to his family with great news. He'd just made the modern equivalent of \$3 billion.

Happy ever after? Not quite.

**The key message in this blink is:
Amassing a fortune is easier
than keeping hold of it.**

Remember what we said about success being a lousy teacher? Well, after his big win in 1929, Livermore thought he was untouchable. He placed larger and larger bets and lost big – again and again, until his

fortune was gone. Broke and indebted, he took his own life in a Manhattan club in 1940.

Getting rich, it turns out, is sometimes a lot simpler than staying rich. It's easy to see why people who are good at the former often struggle with the latter.

Making money is all about risk, optimism, and courage. Keeping money is an entirely different psychological ball game. It's about the fear that everything you've made could be taken away. Staying rich also means being humble. After 1929, Livermore thought he was a

genius who couldn't take a wrong step. He'd have been better off recognizing that luck had played its part – and that his success couldn't be repeated indefinitely.

There are lots of Livermores out there, though their stories aren't usually as tragic. Around 40 percent of all publicly listed companies lose their entire value over time. And the *Forbes* 400 list of America's richest people has a 20 percent turnover per decade, excluding cases of death and intra-family transfers.

So how do you keep what you already have? In a word, perseverance. The entrepreneurs who do best stick around for a long time without wiping out. What they all have in common is a little thing called *fear*. As the multi-billionaire venture capitalist Michael Moritz puts it, when you're scared of losing, you look at potential wins through a different lens. Few gains are large enough to justify risking losing everything you already have. And when you take that view, you're much more likely to make better calls.

**You can be wrong half the time
and still make a fortune.**

According to his own account, Heinz Berggruen didn't show much promise in his youth. When he was forced to flee Nazi Germany in 1936, he wasn't sure what to do with his life.

After studying literature at the University of California, Berkeley, he worked as a journalist with a sideline in art criticism. In 1940, he bought a small watercolor by an artist called Paul Klee for \$100. It was the beginning of a lifelong passion for modern art.

Fast-forward to the 1990s, and Berggruen had become one of the most successful art collectors of all time. In 2000, he sold his collection to the German government for 100 million euros. Given that it contained a large number of Picassos, Klees, Matisses, and Braques, that figure was nowhere close to its real worth, which was estimated at \$1 billion. It was one of the most important collections in the world.

**The key message in this blink is:
You can be wrong half the time
and still make a fortune.**

How did Berggruen amass this impressive collection of the twentieth century's greatest artists? Was it skill, or just luck? The investment firm Horizon Research has a more interesting answer.

According to the company's research, all great collectors do the same thing – they buy vast quantities of art. Some acquisitions turn out to be great investments, especially if the collector holds on to them for a long time. The majority, however, are duds.

The trick, as Horizon's report notes, is to keep the former

until the portfolio return – the value of the entire collection – “converges upon the return of the best elements in the portfolio.”

Berggruen’s collection was a bit like an index fund: his risks were evenly spread across a wide range of investments. Rather than just buying pieces he happened to like or admire, he bought everything he could get his hands on and waited until a few winners emerged.

This strategy applies to all investments. Call it the *long tail* – the tendency of a small number of events to account

for the majority of outcomes. There's a lot of complicated math behind this principle, but it's simple enough when you boil it down to the essentials. Basically, when you get a few things right, you can afford to get more things wrong. Failure is inevitable; what really matters is the *nature* of your successes. Put differently, when you're sitting on one Picasso, you don't have to worry about the 99 duds in your collection.

Final summary

The key message in these blinks:

Financial decision-making is a lot messier in the real world than it is in economics textbooks. Lots of decisions – like buying lotto tickets when you're broke – aren't rational, but they do make sense in their own way. The same goes for investment choices, which are often driven by people's formative experiences of the economy in early adulthood rather than cool appraisals of current market conditions. Put simply, financial calls are entangled with

psychological factors. So what's the best way forward? Well, accept that luck plays a role in success, learn to fear losing what you already have, and hedge your bets.

Got feedback?

We'd love to hear what you think about our content! Just drop an email to remember@blinkist.com with *The Psychology of Money* as the subject line and share your thoughts!

What to read next: *The Behavior Gap*, by Carl Richards

These blinks have illuminated some of the curious ways in which people go about making financial decisions. But although these behaviors have deep roots in the human psyche, that doesn't mean you can't learn to make the right calls.

Take it from financial advisor Carl Richards. Frustrated by years of watching otherwise smart clients make the same mistakes again and again, Richards set out to create a foolproof plan to help investors stop doing dumb things. Want to find out more? Then check out our blinks to *The Behavior Gap!*

Nice work! You're all done with this one.

We publish new books every week at blinkist.com.

Come and see – there's so much more to learn.

Inspired to read the full book?

[Get it here.](#)

Copyright © 2014 by Blinks Labs GmbH. All rights reserved.