

Origins of Greed and Fear

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People with the best intentions and ethics fall for their temptation.*

By Morgan Housel, The Collaborative Fund



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*Some she at once crushes beneath her cruel feet;
others she condemns to a fate like that of galley slaves;
a few she favors and fondles,
riding them high on the bubbles of fortune;
then with a sudden breath she blows the bubbles out and laughs
mockingly as she watches them fall.*

-- James Weldon Johnson on New York City

Greed and fear control everything in investing.

There is no amount of growth that can't be destroyed by an investor's temptation to grab too much of it. And there is no opportunity so appealing that it will catch the eye of someone who refuses to look.

But greed and fear aren't always character flaws. People with the best intentions and ethics fall for their temptation.

The two traits evolve from something innocent: the amount of confidence we have that our actions influence our outcomes.

Figuring out how much of what you do influences what you get requires calculating odds in situations where accurately knowing the odds is impossible. The problem happens when convenience masquerades as a calculation, and you cling to the most comfortable odds by thinking opportunities are more, or less, in your control than they really are. This form of greed -- which has nothing to do with bad ethics -- is pervasive. And this form of fear is innate. But they are powerful. They apply to investments, businesses, industries, and countries. Confronting them just once can make or break a career.

And while greed and fear are typically seen as opposites, they share an origin.

There is a natural cycle where innocent analysis evolves into greed, turns into denial, then confusion, then fear. It often drops you off where you began, with the lesson you think you learned from experiencing fear setting up your next meeting with greed.

Here's how it happens.

Part 1: Greed

Greed begins with the most innocent idea: You deserve to be right.

The decisions you've made. The decisions you'll make. The worldview you hold. The strategy you use. It's hard to wake up in the morning and look in the mirror without telling yourself that you can make good decisions. Nothing would get done if people doubted themselves all day. This is especially true if you've had past success in education and work.

And you deserve to be right because you've put so much effort into developing your views and decisions. You went to school for years. Passed hard tests. Did hard thinking. Put in long hours. No one wants to hear they went through that grind and still don't deserve to be right. And deserving to be right means you should be rewarded for being right. Effort equals reward. That's how the world works, isn't it?

Escaping this thinking is not easy.

It's hard to make it through the day admitting you don't know how the world works. So no one does it. The humblest of people use simplified stories that guide their belief in cause and effect. And it's agonizing to rewrite your worldview, or your investment strategy, or your business model, from scratch after years of effort. So people become good at clinging to views even when they're built on flimsy evidence.

Whatever you happen to believe is right and you deserve to be right and rewarded for being right. It's a common and innocent idea that causes us to be less open-minded to the complexity of an evolving world than we ought to be.

And here is where things get messy.

When you are rewarded for being right -- especially an above-average reward -- a door opens inside your head that invites delusion to come inside.

In a rational world we'd try to calculate how much of what we did influenced what happened. We'd recognize that if you did *this* and then *that* happened, there are a million other variables you have no control over that also could have influenced *that* outcome.

But it's not a natural way to think.

The default position when you're rewarded is to assume that you doing this caused that to happen. If you're looking for an answer of why that happened, it is the path of least resistance. Because, after all, your views are right and deserve to be rewarded. So of course the thing you like was caused by the thing you did.

Others believe this as much as you.

People watch you get a reward and -- because they extrapolate how they would feel if they got a reward -- get excited by your achievement. Praise. Attention. Admiration. It all feels good to you and reinforces the idea that you got rewarded because your views and actions were right. You are likely to believe anyone who tells you you're special.

And you want more of it.

Success makes it easy to say, "I was right before, so hold my beer while I double down."

This isn't crazy. It's part reasonable analysis; you tested the waters and were proven right, so now dive in. And it's part social comparison; the buzz you got from being a little right wore off. Now you want to be right with scale.

This is an important part of greed: People justify their actions, even if in hindsight those actions were crazy. It's different than knowing your actions are reckless and harmful but doing them anyway. That's psychopathy. The common form of innocent greed is just extrapolating with enthusiasm what worked in the past.

It tempts you to do the same thing as before, but with twice the appetite.

Same job, but demand more pay. Same investment, but with leverage or concentration. Same business model, but with pushier marketing. Or the exact same thing, but now as a full-time career.

This is fine to do if your actions directly influence outcomes. If your doing *this* causes *that*.

But if you overestimate how much of your previous outcomes were caused by identified actions that were in your control, then doubling down on what happened to work before increases the odds of future failure.

Greed happens when you overestimate how influential your past actions were on outcomes, enticing you to keep pushing right up to, and beyond, the point of eventual regret.

Maybe you underestimate how much of past success was being in the right place at the right time.

Or having the help of people who have since left.

Or social/economic trends and regulations that won't be repeated.

Whatever the cause, sometimes you become so convinced your actions are right that the economy -- which despises outliers and egos -- views it as a taunt and reminds you that things are more complicated than you assumed.

What worked in the past suddenly doesn't work today. And since you double-downed on what worked before, now you're in trouble.

Greed is expecting back more than you deserve given what you put in. Which is exactly what happens when you overestimate your ability to do things that will directly lead to rewards.

You don't know it yet, but now the seeds of fear were just planted.

Part 2: Fear

The first reaction to greed backfiring is to view it as an opportunity.

If a novice with no record of success experiences a loss or a failure, they are likely to think the results reinforce the idea that they have no skill and have no idea what they're doing.

But if you mistakenly think your skill has been confirmed to the point where you've become greedy, experiencing a loss is first interpreted as the world giving you a new opportunity.

“Ah, my investment strategy didn't work but prices are lower now and that's great.”

“Ah, the company denied my raise so now I can find a new job at a place that appreciates me.”

“Ah, my management style hurt employee morale but now the weak hands will leave the company.”

You will never hear this kind of stuff from someone who hasn't experienced past success. It only comes from someone who's convinced that their past actions have caused their past results.

Their response, often, is to double down yet again. With more confidence.

When you've overestimated how much of your actions influence your results, you miss key feedback the world tries to give you, sticking to your guns instead of updating your approach. You keep plugging ahead, which seems like an admirable trait. You may throw more effort at the strategy, convinced it will pay off with even bigger rewards when you're eventually proven right.

You think you're being patient, but you're actually being stubborn.

Buddhism has a concept called Beginner's Mind, which is an active openness to trying new things and studying new ideas, unburdened by past preconceptions, like a beginner would. Assuming you have skill can be the enemy of beginner's mind, because past success reduces the incentive to explore other ideas, especially when those ideas conflict with your proven strategy. It's dangerous. Being locked into a single view is fatal in an economy where reversion to the mean and competition constantly dismantles old strategies.

When you give up a flexible mind, you are now immune to feedback. So now you are indeed less prepared than a beginner, or even someone attempting random strategies in the dark.

The odds of your continued failure now escalate.

After multiple failures, you begin to view yourself as a victim.

You have not yet admitted the possibility that perhaps you were never as skilled as you once imagined, even to yourself.

You see the world as acting against you.

You blame short sellers for driving stock prices down.

The media for unfairly covering your company.

The Fed for distorting asset prices. Politicians for holding the economy back.

Anything but looking in the mirror.

On a (far) different level, just before shooting himself in his bunker, Hitler allegedly told his aides that Germany lost the war because its citizens didn't appreciate his leadership.

At this point greed is dead, but denial about your contributions and skill is at its highest.

You try to reduce risk without abandoning ship. Maybe some layoffs. Maybe sell part of your investment. Or apologize to those you offended.

You have not given up hope. But you recognize you need a change and are confident you can get back on track.

At this point you have admitted to yourself that you engaged in excess. But you still haven't admitted you were wrong, even a little. Your fault, in your mind, is that you pushed too much of a good thing. But your thing still looks good. It's still right. It still deserves to be rewarded.

So you carry on, with a little less enthusiasm than before.

You can only maintain delusion for so long. Eventually the people you relied on -- employees, investors, customers -- lose faith in your skill and move on.

Sometimes it takes days for that to happen, sometimes years. But it will happen.

And it is the point where you start to wonder whether you've missed something along the way.

You don't yet realize you were wrong. Wrong is painful. But -- perhaps -- your views were incomplete.

This is when people start saying things like "We've learned a lot in the last year" and "This has been a growth experience."

Sometimes these statements are honest and correct. But often they're just the barest-bone acknowledgement of reality to you and others that prevent you from looking utterly out of touch with reality. Deep down, your core views and faith in your ability are still mostly intact.

But you keep failing.

There comes a point where it's obvious, even to you, that you are wrong. Privately, to yourself, you wonder whether you were wrong. On occasion you admit that yes, you were.

To deal with the pain you often employ denial. When friends ask you how work or business is going, you change the subject, nearly to the point of denying you were ever involved with the thing you once went all in on. "It was never that important to me," or "It was always a small part of what we do."

Reality rushes in when your mistakes force lifestyle changes. When you're forced to sell your house or your car, or cancel a vacation, or move into a smaller office, the consequences of your wrongness are now undeniable to outsiders watching you.

Now you're embarrassed. And once you're embarrassed, your ability to look at a problem with a cool, rational mind becomes as clouded as it was when you were in the peak of greed.

A little doubt that you were wrong now cascades into panic.

You avoid people who you'd normally talk to about your skill, which walls you off even more from the ability to take feedback and gain context on your situation. You're now stuck in your own mind, which is a doom loop of fear and doubt.

Your mindset shifts from growth to damage control. You stop thinking about opportunity and gain. Your definition of success is now when you stop falling behind.

Anything that prevents further loss now looks like an appealing gain.

So you sell what you have left. Leave your career. Abandon your company. Capitulation.

When you were greedy you believed that 100% of what you did influenced the gains you received. Now you think there's nothing you can do that's in your control that will deliver upside. The hard thing is, you're as wrong now as you were back then. But you're equally blind to that reality.

You begin looking around at everyone else. The people you once looked down upon now sit so much higher than you. What happened? Why aren't they suffering like you? Do they know something you don't?

That's a new fear to worry about.

When you were successful, people watched what you were doing and tried to copy it. They wondered what you knew that they didn't. They didn't want to miss the rewards you were getting.

Now the process goes in the other direction. You start looking at other people who have done better than you and wonder what else they know that you don't. But since you're now gripped with fear, you're not looking for upside opportunities. You wonder what other landmines exist that smarter people have avoided but you might still be oblivious to.

Fear does the most damage when your biggest fear is wondering what else you should be fearful about.

You become as blind to what positive things might happen as you were to what negative things might happen when you were greedy.

The irony is that markets and businesses unwinding is often the most fertile ground for opportunity. But opportunity is the last thing you're thinking about. You're focused on not falling down any further.

At some point you find stabilization. Markets calm down. People begin to forgive you. Fear gives way to acceptance. You lost a lot of what you once had, but now you can think with a clearer head.

The first thing you vow is to never make the same mistake again.

The pain you went through with fear was 10 times harder than the joy you got from greed. If there's a silver lining from this debacle, it's that you've learned your lesson and can avoid the same errors in the future.

You now have a new worldview. A new strategy on how to operate in markets, business, and life, shaped by the mistakes you made when you fell for the trap of greed and fear. You now know how to act when opportunity presents itself.

You feel confident about this new view. You deserve to be smarter now. Going through something as hard as you've been through and not coming away smarter seems unfair. You were wrong before, but now you're right. No one wants to hear they went through that painful grind and still don't deserve to be right.

And deserving to be right means you should be rewarded for being right. Effort equals reward. That's how the world works, isn't it?

It's hard to wake up in the morning and look in the mirror without telling yourself that you can make good decisions.

Isn't that an innocent view?

That you deserve to be right?

And now we're right back to where this story began.



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