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THE GROUPTHINK DILEMMA

By: Robert Klosterman, CEO & Chief Investment Officer

Recently a client asked a question about what assurance I could give him that our firm was not participating in “Groupthink” (in the investment markets). Naturally my initial reaction was a bit defensive as we pride ourselves in not following the crowd consensus. In some ways the question is unanswerable because the more the issue is defended the more questions may come up about one’s objectivity. Yet, the nature of the question was more about what is being done to assure that the culture of independent thought is part of what we do, not an occasional or accidental occurrence.

Groupthink as defined by Wikipedia:

Groupthink is a psychological phenomenon that occurs within groups of people. It is the mode of thinking that happens when the desire for harmony in a decision-making group overrides a realistic appraisal of alternatives. Group members try to minimize conflict and reach a consensus decision without critical evaluation of alternative ideas or viewpoints. Antecedent factors such as group cohesiveness, structural faults, and situational context play into the likelihood of whether or not groupthink will impact the decision-making process.

The primary and socially negative cost of groupthink is the loss of individual creativity, uniqueness, and independent thinking. As a social science model, groupthink has an enormous reach and influences literature in the fields of communications, political science, social psychology, management, organizational theory, and information technology.[1]

The majority of the initial research on groupthink was performed by Irving Janis, a research psychologist from Yale University. His original definition of the term was, “A mode of thinking that people engage in when they are deeply involved in a cohesive ingroup, when the members' strivings for unanimity override their motivation to realistically appraise alternative courses of action” (Janis, 1972).[2] Since Janis’s work, other studies have attempted to reformulate his groupthink model. 'T Hart (1998) [3] developed a concept of groupthink as “collective optimism and collective avoidance,” while McCauley (1989)[4] pointed to the impact of conformity and compliance pressures on groupthink decisions.

Independent thinking is critical to long-term investment success. One only needs to look at extreme lows and highs in sentiment indicators to find major turning points in the investment markets. Swimming with the current on sentiment (Groupthink) can leave one in a less than desirable position.

Some would blame the media for accentuating the extremes with short segments. While the media may be an easy target, it is important to recognize that the currency of the media is attention which translates into advertising dollars. As long as this is true, short and highly charged topics will dominate the screens and sound waves. Once one accepts that not all sides of an issue are represented in convenient forms, one must seek out both sides of any issues they care about having balanced answers to.

Like a debate team one must be able to successfully argue both sides on an issue to have the balance to make a decision that is right for them. In our opinion sentiment indicators at their extremes are signals to assess whether or not you are prepared for such movements.

Our firm believes that the following techniques help keep “Groupthink” at bay:

Research From Multiple Sources: Being an independent firm we get a variety of high quality research from many prestigious firms. One may think that these firms use this research for themselves and their high value clients. This is true and we fit into the latter category due to our design as a fee-only, independent firm with significant influence and control over how money is allocated. The fact that our decisions can move multiple millions of dollars to a new idea puts us in that position.

Independent and Paid Research: If you tend to be a little skeptical of things you get for free (and we are!) then you may put more emphasis on the independent work you do internally and the sources you pay for. A huge part of our decision making is driven by independent sources. Many firms don’t feel a need to do this, but we happily pay the cost involved to get third party research and recognize it isn’t cheap to do.

Combining the independent and paid research with the “free” research one can get a clearer, well rounded set of opinions and data from which to draw conclusions from.

Seek to Understand Multiple Sides of an Issue: There are few absolutes in portfolio construction despite vigorous assertions by many to the contrary: active versus passive, valuations of the investment markets, views on the current state of the economy, value of allocations to alternative investments and many other questions. The most dangerous position to hold is that one side is always best and all other views should be ignored. A better option is to have the depth of understanding for all sides of an issue rather than a dogmatic “this is the only way to do things” approach.

Of course, one must have views and beliefs to move forward with any decision and understanding all sides does not mean taking no stands on certain issues, but sometimes the best answers fall in the middle of extremes rather than on the fringes. Internally our investment committee is encouraged to enter into debates and look at opportunities from a variety of perspectives to make sure we aren’t subjecting ourselves to unnecessary risks or missing opportunities. Exposing ourselves to a wide variety of philosophies and opinions and considering multiple options is the only way we know how to do this successfully.

Be a Student of the Process: Everyone wants to be an expert, yet the best experts are the ones who consider themselves as still learning everyday about an area of expertise. Only by continuously learning, attending conferences, reading relevant material, examining new thinking and challenging existing ideas does one stay current in their area of expertise. Our world today has several examples of the “them’s” and the “us’s” with options for each to selectively get the news that fits their views, the information they like and so on. True students will be careful to watch for innovations and new approaches to their area of expertise.

Whether one seeks to manage their own wealth using these principles or seeks an advisor, by casting a wide net with an open mind and using critical thinking to arrive at well thought out solutions, we believe the probability of success rises significantly. If an outside advisor is appropriate what questions might be appropriate to help ascertain a potential good fit? We offer the following:

What is your philosophy about managing money and how did you come to it?

What tools do you use to keep you current on relevant investment trends?

What are your sources of investment research and data?

What is your budget for investment research?

What are your most important sources of investment information?

Please describe your investment decision making process. Who is involved?

What books, seminars, conferences have you gleaned information from in the last year?

How do you judge investment success?

Groupthink is most dangerous at the tops and bottoms of investment cycles. By following thoughtful, disciplined processes, exposing yourself to multiple ideas and perspectives one can minimize the potential to be lured into following the crowd. This will allow important ideas to come to the surface and be acted upon to improve the probability of a successful outcome.

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