Would Raj risk it all for a mere $45 million?

/ **By Denise Shull**

GIVEN THE SIZE AND returns of his funds and his reported personal net worth, it doesn't make sense that Raj Rajaratnam—who is on trial for insider trading and mounting a vigorous defense—would commit the crimes being alleged to earn a mere $45 million. From the point of view of any sort of rational model of decision making, a billionaire risking prison for that type of reward would be nutty.

But those who study behavioral finance have known for some time that people rarely make numerically logical bets. It doesn't take a quant with a Ph.D. in physics to know humans have other motivations.

Now, the world loves a bad guy. We get to point our fingers and say, "You greedy no-good billionaire," and somehow that makes us lesser net-worthers feel better about ourselves. But does it do anyone—investors, the SEC, the purported perps or even the average disgusted observer—a bit of good if it misses the real motivation?

What if it isn't greed? What if it is something else?

By all accounts, Raj had it all—a spectacularly successful fund, a Sutton Place home, a wife and three children, and outsize respect in his home country. He clearly also had lots of friends. Yet the *New York Times* quoted him as saying he felt as if he came into the office every day to fight Muhammad Ali. Could it simply be that some people want to win the fight regardless of the reward?

First of all, it may come as a surprise to the MBAs of the world, but any decision requires an emotion. Neuroscientists have proven this beyond a shadow of a doubt, and even our latest phenom computer, Watson, simulates a feeling when it adds a confidence level to its potential *Jeopardy* answers. This means we can take the inverse question—what emotion drove the decision?—and analyze that angle for a plausible answer.

Deborah Tannen, the linguist who quantified the realization that men don't like to ask for directions in her 1990 book, "You Just Don't Understand," wrote in *Scientific American Mind* magazine last spring that after 30 years and thousands of examples, she has found that men's talk leans toward hierarchy and competition. She says that men usually evaluate an interaction from the vantage point of "Am I one up or one down?" She illustrates with taped conversations of young boys, who will typically respond to a comment with some version of "I've got one better," whether it be how many days they got to spend at Disney World or how far they can hit a baseball.

There is another theory about human choice that rarely gets any airtime on Wall Street but that fundamentally speaks to the choices all of us make. That is regret theory, first published by two different authors in the early 1980s. It matches up much more closely with what traders really do and how they really talk about their market decisions.

In practical terms, it amounts to a fear of missing out (that is, fear of feeling regret in the future). No one wants to look back and know "I could have made that money" or "I was right about that trade, but I got out too early." In my work with sophisticated traders, I often hear their postmortem reviews of trades, and I can tell you this perceived avoidance of feeling bad motivates more market decisions than any other type of feeling.

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In retrospect, titans of finance who were caught behaving badly often didn't need the money they made through their illicit activities. They needed to keep winning the fight, and to avoid feeling that they'd had a chance and blown it. It's easy for traders to predict and work to avoid regret. A fear of jail is, for most traders, an abstract concept that's harder to envision.

In 2005, Colin Camerer of the California Institute of Technology and two colleagues published an article titled "Neuroeconomics" in the prestigious *Journal of Economic Literature*. One of their statements was "It is not enough to 'know' what should be done; it is also necessary to 'feel' it." In practical terms, their declaration should be taken one step further. The latest neuropsychoanalysis suggests that their statement extends not only to the feelings we would expect, such as a desire to create a top-performing fund, but to the insidious and almost always more compelling ones, like a supersize need for and enjoyment of being "one up."

As investors discover anew every few years, it's difficult to predict and avoid the traders who will risk it all for seemingly irrational gains. We all want our money managers to be clever and aggressive, but it's crucial to figure out whether their motivation is for something as rational as money or as irrational as winning in all contests, regardless of the stakes. AR

Denise Shull is CEO of the ReThink Group, parent company of TraderPsyches and SportsPsyches, organizations that counsel traders and athletes on improving their performance.