

Global Equity Strategy

If it makes you happy

The psychology of happiness

If you are after specific investment advice, stop reading now. We seek to explore one of Adam Smith's obsessions: what it means to be happy. We also discuss why that's important to investors, and how we can seek to improve our own levels of happiness. The list below shows our top ten suggestions for improving happiness.

- ▶ **Don't equate happiness with money.** People adapt to income shifts relatively quickly, the long lasting benefits are essentially zero.
- ▶ **Exercise regularly.** Taking regular exercise generates further energy, and stimulates the mind and the body.
- ▶ **Have sex (preferably with someone you love).** Sex is consistently rated as amongst the highest generators of happiness. So what are you waiting for?
- ▶ **Devote time and effort to close relationships.** Close relationships require work and effort, but pay vast rewards in terms of happiness.
- ▶ **Pause for reflection, meditate on the good things in life.** Simple reflection on the good aspects of life helps prevent hedonic adaptation.
- ▶ **Seek work that engages your skills, look to enjoy your job.** It makes sense to do something you enjoy. This in turn is likely to allow you to flourish at your job, creating a pleasant feedback loop.
- ▶ **Give your body the sleep it needs.**
- ▶ **Don't pursue happiness for its own sake, enjoy the moment.** Faulty perceptions of what makes you happy, may lead to the wrong pursuits. Additionally, activities may become a means to an end, rather than something to be enjoyed, defeating the purpose in the first place.
- ▶ **Take control of your life, set yourself achievable goals.**
- ▶ **Remember to follow all the rules.**

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If it makes you happy

With apologies to Monty Python, this weekly is perhaps best summed up as “And now for something completely different”. We have a reputation (admittedly deservedly) for being bearish. Indeed, on occasions, we even manage to depress ourselves. However, as professional pessimists it behoves us to be happy in other aspects of our lives. Those of you who are amongst our regular readers may recall that Albert Edwards has documented his own search for happiness with a weekly concerning his exploits at speed dating (see *Global Strategy Weekly*, 15 January 2004).

Albert’s adventures have inspired me to, once again, drag the psychological literature. The psychological study of well-being and happiness is still a relatively new field. However, despite its relative youth, the field has already delivered some powerful insights and advice.

But before we get to these, let’s start at the beginning. Why be happy? The psychological literature shows that effectively the benefits of happiness can be broken down into three areas. These may seem like a long list of the blindingly obvious, but all are based on careful scientific studies (rather than cheap self help books!).¹

- i) Social rewards
 - a. Higher odds of marriage
 - b. Lower odds on divorce
 - c. More friends
 - d. Stronger social support
 - e. Richer social interactions
- ii) Superior work outcomes
 - a. Greater creativity
 - b. Increased productivity
 - c. Higher quality of work
 - d. Higher income
 - e. More activity, more energy
- iii) Personal benefits
 - a. Bolstered immune system

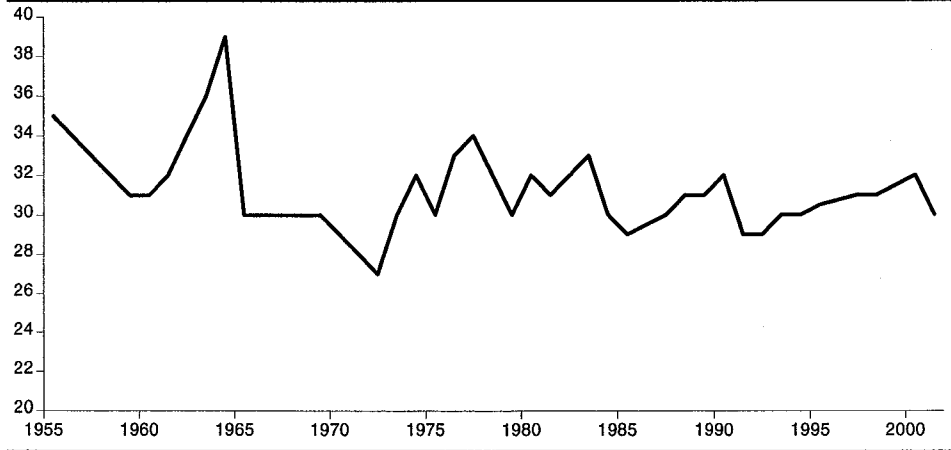
¹ Anyone wanting more on the benefits of happiness is referred to the massive volume of work carried out by Professor Lyubomirsky (<http://faculty.ucr.edu/~sonja>)



- b. Greater longevity
- c. Greater self control and coping abilities

So let's assume that you share the desire to enjoy this list of happiness-induced benefits (and I'd be surprised if anyone had issues with any of these benefits), how do you go about becoming happy?

Percentage of Americans describing themselves as very happy



Source: NOCR

In order to understand how we can improve our level of happiness we need to understand its components. The latest research suggests that happiness is composed of three sections².

The largest contributor to happiness is the genetically determined set point (or more accurately set range). That is to say, people are pre-disposed to a certain level of happiness, which is determined by characteristics inherited from their parents! As Sheldon et al note *"The set point likely reflects immutable interpersonal, temperamental and affective personality traits, such as extraversion, arousability and negative affectivity, that are rooted in neurobiology, ...are highly heritable... and change little over the lifespan."*

Adam Smith, author of the Wealth of Nations, also wrote the Theory of Moral Sentiments, a text far closer to understanding the nature of human beings than the better known favourite of economists³. Smith noted *"The mind of every man, in a longer or shorter time, returns to its natural and usual state of tranquillity. In prosperity, after a certain time, it falls back to that state; in adversity, after a certain time, it rises up to it"*.

Current estimates suggest that this genetically determined set range accounts for around 50% of an individual's happiness. However, the set point is only the base line

² Sheldon, Lyubomirsky and Schkade (2003) Pursuing Happiness: The Architecture of Sustainable Change

³ Indeed a new paper by Ashraf, Camerer, and Loewenstein (2004) argues that Adam Smith was actually one of the first behavioural economists. They cite the Theory of Moral Sentiments as a good example of how insightful Smith really was.



or default level of happiness that an individual enjoys. It is the level of happiness that an individual would have in the absence of other factors. Because the set point is generally fixed, it is not something we can alter in order to improve our happiness lot. This, of course, means that in order to increase our happiness we need to look elsewhere.

The second component of happiness is circumstances. Life circumstances include demographic factors, age, gender, ethnicity and geographic factors. It also includes personal history and life status. Frequently people focus upon the last element of this feature.

Indeed, amongst the most commonly reported correlates of happiness are marital status, occupation, job security, income, health and religious affiliations. In general, married, well paid, secure, healthy and religious believers are more likely to report themselves as being happy than the rest of us.

That said, a vast array of individuals seriously over-rate the importance of money in making themselves, and others, happy. Indeed, it seems to me that an awful lot of individuals within our industry tend to equate money with happiness.

However, study after study from psychology shows that money doesn't equal happiness. For instance, Loewenstein (1996) asked visitors to Pittsburgh International Airport to rank from 1 (most important) to 5 (least important) a list of "things that might be important when it comes to making people happy". They were then asked to assign percentages as to the importance of each factor in determining overall happiness. The table below shows the mean ranking and percentage weights that respondents assigned to each variable. High income received the lowest ranking and rating.

Rankings and ratings of happiness factors

| Item | Mean rank | Mean points |
|----------------|-----------|-------------|
| Family Life | 1.7 | 37 |
| Friends | 2.4 | 22 |
| Satisfying job | 2.5 | 26 |
| High income | 3.6 | 15 |

Source: Loewenstein

A similar finding is contained by Diener and Oishi (2000)⁴ who surveyed some 7167 students across 41 countries. Those who valued love more than money reported far higher life satisfaction scores than those who seemed to be money focused. (See chart p5).

However, for all the emphasis that gets put upon life circumstances as a generator of happiness, the correlations between such variables as money, job security, marriage etc and happiness are relatively small. In fact, Sheldon et al argue that in total all circumstances account for only around 10% of the variations in people's happiness.

⁴ Diener, E and Oishi, S (2000) Money and Happiness: Income and subjective well-being across nations



Money ≠ happiness



Source: Diener and Oishi (2000)

There is an additional problem with changing life circumstances as a path to increasing happiness. It goes by the frightening name of hedonic adaptation⁵. Simply put, hedonic adaptation means we are very good at quickly assimilating our current position, and then judging it as normal, hence only changes from our “normal” level get noticed.

Gains in happiness quickly become the norm. So changing life circumstances seems to lead to only temporary improvement in people’s happiness. This helps explain the chart on p3, which shows that since the 1950s people’s happiness levels have been remarkably constant, despite a massive growth in income per head over the same time horizon.

Schkade and Kahneman (1998)⁶ show that whilst “living in California” was an appealing idea for many Americans, it didn’t actually boost long run happiness. That is to say, people living in California were about as happy as other Americans on average. So whilst moving may provide a temporary increase in happiness, it is soon adapted into the perception of the “norm”.

Hence hedonic adaptation severely limits the ability of changing life circumstances to improve long run happiness. So neither life circumstances nor the set point seem to hold the key to creating sustainable increases in happiness.

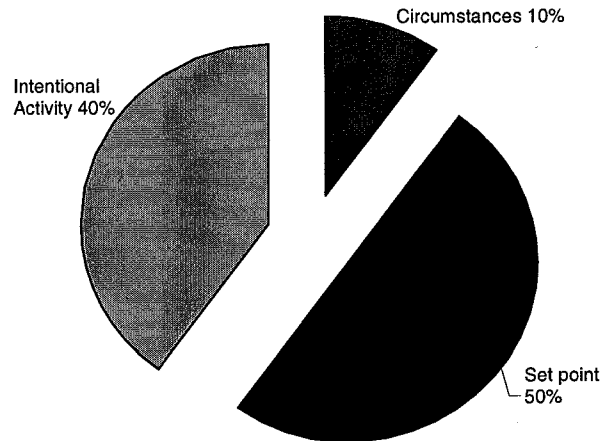
All of which means that any hope for increasing happiness on a long term basis must lie with the third and final component of happiness – intentional activity. Sheldon et al define intentional activity as “discrete actions or practices that people can choose to do”. By process of elimination, intentional activity must account for 40% of people’s happiness.

⁵ Frederick and Loewenstein, Hedonic Adaptation in Well-Being: The foundations of hedonic Psychology, ed. Kahneman, Diener and Schwarz (1999)

⁶ Schkade and Kahneman (1998) Does living in California make people happy?, Psychological Science, 9



Contributions to happiness



Source: Sheldon et al (2003)

Intentional activity can be (somewhat artificially) broken down into three areas:

Behavioural activities – such as exercising regularly, having sex⁷, being kind to others, and spending time socialising.

Cognitive activities – such as trying to see the best, pausing to count how lucky one actually is.

Volitional activities – striving for personal goals, devoting effort to meaningful causes.

Unlike changing life circumstances, intentional activity is likely to be more resistant to hedonic adaptation. The very nature of activities means they are episodic, and hence are unlikely to become part of the “norm” in the way alterations to circumstances do. Because activities are not permanent they can be varied which again helps prevent hedonic adaptation. For instance, in taking exercise the particular activity can easily be altered from cycling to swimming.

Cognitive activities such as pausing to think about the good things in one’s life can also help counteract the hedonic adaptation process directly. After all, counting one’s blessing helps to prevent them from becoming part of the “norm”.

Of course, just like New Year’s resolutions, happiness increasing strategies are relatively easy to devise, but far harder to implement on a consistent basis. A deliberate effort is required to pursue activities. However, an individual has much more chance of being able to start an activity than say change the set point or alter life circumstances. So just how can we seek to improve our intentional activities to enhance happiness? Well the list below is drawn from my reading of the literature, all of these have withstood laboratory testing in a scientific environment.

⁷ In Kahneman, Krueger, Schkade, Schwarz and Stone (2003) Measuring the quality of life, the authors found that among a sample of 1000 employed women that sex was rated retrospectively as the activity that produces the largest amount of happiness. Commuting turns out to be the least pleasurable activity. Also Blanchflower and Oswald (2004) Money, Sex and Happiness, find that sexual activity enters strongly into happiness equations.



The top ten list for improving happiness (in no particular order)

- 1) **Don't equate happiness with money.** People adapt to income shifts relatively quickly, the long lasting benefits are essentially zero.
- 2) **Exercise regularly.** Regular exercise is an effective cure for mild depression and anxiety. It also stimulates more energy, and is good for the mind and body.
- 3) **Have sex** (preferably with someone you love). Need I say more?
- 4) **Devote time and effort to close relationships.** Confiding and discussing problems and issues is good for happiness, so work on these relationships.
- 5) **Pause for reflection, meditate on the good things in life.** Focusing on the good aspects of life helps to prevent hedonic adaptation.
- 6) **Seek work that engages your skills, look to enjoy your job.** Doing well at work creates happiness, and the easiest way of doing well at work, is doing a job you enjoy.
- 7) **Give your body the sleep it needs.** Too many people have a sleep deficit, resulting in fatigue, gloomy moods and lack of concentration.
- 8) **Don't pursue happiness for its own sake, enjoy the moment.** Because people don't understand what makes them happy, pursuing happiness can be self-defeating. Additionally, if people start to aim for happiness they are doing activities for happiness's sake rather than actually enjoying the activity itself.
- 9) **Take control of your life, set yourself achievable goals.** People are happiest when they achieve their aims, so set yourself goals which stretch you, but are achievable.
- 10) **Remember to follow rules 1-9.** Following these guidelines sounds easy, but actually requires willpower and effort.

Let's leave the last words to Adam Smith (quoted in Adam Smith, Behavioural Economist by Ashraf et al (2004) from the Theory of Moral Sentiments):

Through the whole of his life he pursues the idea of a certain artificial and elegant repose which he may never arrive at, for which he sacrifices a real tranquillity that is at all times in his power, and which, if in the extremity of old age he should at last attain to it, he will find to be in no respect preferable to that humble security and contentment which he had abandoned for it. It is then, in the last dregs of life, his body wasted with toil and disease, his mind galled and ruffled by the memory of a thousand injuries and disappointments which he imagines he has met with from the injustice of his enemies, or from the perfidy and ingratitude of his friends, that he begins at last to find that wealth and greatness are mere trinkets of frivolous utility, no more adapted for procuring ease of body or tranquillity of mind, than the tweezer-cases of the lover of toys.



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(Except as otherwise noted, expected performance over next 12 months)

| | | | |
|------|--|--------|-------------------------------------|
| Buy | 10% or greater increase in share price | Reduce | 5-10% decrease in share price |
| Add | 5-10% increase in share price | Sell | 10% or more decrease in share price |
| Hold | +5%/-5% variation in share price | | |

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| | All covered companies | | Companies where a DrKW company has provided investment banking services (in the last 12 months) | |
|-------------|-----------------------|-----|---|-----|
| | | | | |
| Buy/Add | 337 | 53% | 55 | 57% |
| Hold | 188 | 30% | 31 | 32% |
| Sell/Reduce | 108 | 17% | 11 | 11% |
| Total | 633 | | 97 | |

Source: DrKW