# Rational vs. Reasonable

Dec 11, 2018 by [Morgan Housel](https://www.collaborativefund.com/blog/authors/morgan/)

I’m going to explain why it’s OK to make irrational investment decisions. First, a story about a guy who won the Nobel Prize for infecting syphilis patients with malaria.

Julius Wagner-Jauregg was a 19th-century psychiatrist with two unique skills: He had exceptional pattern-recognition skills, and what others saw as “crazy” he found merely “bold.”

Wagner-Jauregg noticed that patients with severe neurosyphilis—then a fatal diagnosis with no known treatment—tended to recover if they had the added misfortune of having prolonged fevers from an unrelated ailment. He figured this was due to the long-known idea that fevers assist the body’s fight against infection. So he jumped to the logical conclusion. In the early 1900s he injected patients with low-end strains of typhoid, malaria, and smallpox to trigger fevers strong enough to kill off their syphilis. A weak version of malaria worked best, since it could be countered with quinine after a few days of bone-shaking fevers.

Wagner-Jauregg reported that 6 in 10 syphilis patients treated with “malariotherapy” recovered, compared to around 3 in 10 patients left alone. He won the Nobel Prize in medicine in 1927.

Penicillin eventually made malariotherapy for syphilis patients obsolete. But Wagner-Jauregg is one of the only doctors in recent history who not only recognized the fever’s role in fighting infection, but prescribe it as a treatment.

Fast forward to today and there is better, more scientific evidence of fever’s often helpful role in fighting infection. “Numerous investigators have identified a better outcome among patients who displayed fever,” one NIH paper [writes](https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3681366/#B15).

Yet fever is viewed as an enemy.

It’s universally treated with drugs like Tylenol to eliminate it quickly. Despite four million years of evolution as a defense mechanism, no patient, few doctors, and certainly no drug company views fever as anything but a nuisance. One study [was blunt](https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4703655/): “Treatment of fever is common in the ICU setting and likely related to standard dogma rather than evidence-based practice.”

Why does this happen?

I don’t think it’s complicated.

A doctor’s goal is not just to cure disease. It’s to cure disease within the confines of what’s reasonable and tolerable to the patient. Fevers can have marginal benefits in fighting infection, but they hurt. And I go to the doctor to stop hurting. I don’t care about double-blind studies when I’m shivering under a blanket. If you have a pill that can make a fever stop, give it to me now.

It may be rational to welcome a fever, but for most people it’s not reasonable.

And that framework—aiming to be reasonable instead of coldly rational—is one investors should consider.

My theory is that most investment models maximize for risk-adjusted returns, but in the real world every investor wants to maximize for sleeping well at night and being proud of themselves in a complicated world.

Harry Markowitz won the Nobel Prize for exploring the mathematical tradeoff between risk and return. A few years ago the Wall Street Journalasked him how, given his work, he structured his own portfolio. He [replied](https://www.wsj.com/articles/SB123093692433550093):

*I visualized my grief if the stock market went way up and I wasn’t in it – or if it went way down and I was completely in it. My intention was to minimize my future regret. So I split my contributions 50/50 between bonds and equities.*

“Minimizing future regret” is hard to rationalize on paper but easy to justify in real life. A rational investor makes decisions based on facts. A reasonable investor makes them in a conference room surrounded by coworkers who need to be persuaded, at the dinner table with a spouse you don’t want to let down, or judged against the silly but realistic “competitors” that are your brother-in-law, your neighbor, and your own personal doubts. That’s OK. It’s real life. Better to embrace reality today than pretend it doesn’t exist and be slapped by humility tomorrow.

Years ago I interviewed Daniel Kahneman. This part stuck with me:

***Morgan Housel****: What has been the biggest shift in your thinking after all your years of research?*

***Dr. Kahneman****: That’s a hard one. When I started in this line of work with Amos 40 years ago, we believed that imposing your rationality on thinking was a feasible objective. I was a great believer in decision analysis and in systematic approaches to decision making. And I believed that was going to happen.*

*And then it turns out that decision analysis … has not conquered the world as I expected it to. So from that point of view I may have become a little more pessimistic than I was. I really thought that you could improve systems of judgment and of decision making fairly easily. I still believe they can be improved, but I’m less optimistic about it.*

Rational is hard. Being reasonable is often the most practical goal.

A few examples in investing:

“Be greedy when others are fearful, and fearful when others are greedy,” is rational, but hard. Howard Lindzon [gave it](http://howardlindzon.com/be-fearful-before-others-are-fearful-and-less-greedy-in-general/) a makeover: “Be fearful before others are fearful and less greedy in general.” That’s more reasonable.

There’s a well-known home bias, where people prefer to invest in companies from the country they live in while ignoring the other 95%+ of the planet. It’s not rational, until you consider that investing is effectively giving money to strangers. And if familiarity helps you take the leap of faith required to remain backing strangers, it’s reasonable.

Day trading and stock picking aren’t rational for most investors. But they’re reasonable in small amounts if they scratch an itch hard enough to keep you out of bigger trouble.

Most forecasts are terrible, but making forecasts is reasonable. It’s hard to wake up in the morning telling yourself you have no clue what the future holds, even if it’s true. Acting on investment forecasts is dangerous, but I get why people try to predict what will happen next year. It’s human nature.

My asset allocation doesn’t fit any financial advisors’ stock model. I’m an optimist who holds an amount of cash consistent with impending catastrophe. But it works for me. It’s reasonable for me. I can’t rationalize it on a spreadsheet, but I can explain it in the context of the kind of life I want for me and my family. I get miserably high fevers. Maybe that’s part of it.

Kahneman’s best work was documenting loss aversion—the idea that people hate losing more than they enjoy winning.

I asked him: Is it rational?

“Well, that’s a complicated issue,” he said. “If it’s rational to live with whatever your nature is and to try to enjoy life as much as possible, then loss aversion is just a fact of life, like regret.”

“You may think that regret is a foolish emotion. But if you know that you’re going to be susceptible to regret, it is not irrational to anticipate it and to act accordingly.”

That seems reasonable.