



Whether it's the "irrational exuberance" of the last decade or the apocalyptic view that prevailed last winter, investor psychology tends to be shortsighted and veer toward extremes. But investors need to overcome myopia and getting lost in the moment, Michael Mauboussin, the chief investment strategist of mutual fund giant Legg Mason Asset Management argues. And in his [new book](#) *Think Twice: Harnessing the Power of Counterintuition* (Harvard Business School Press), he attempts to outline how all decision-makers can be aware of and counter their own biases.

Investors need to test the worldview that spirals out of a situation -- what Mauboussin calls the "inside view" -- with a broader perspective that takes factors like history and statistics into account.

He points to the [euphoria surrounding](#) racehorse Big Brown's chances of winning the Triple Crown in 2008 following a hot streak as an example of how participants can get carried away in the moment. Caught up in the excitement, fans and racing experts were far too optimistic about Big Brown's prospects. But a quick look at other horses running similar races would have shown that Big Brown actually faced much tougher odds -- and indeed the horse finished dead last in the Belmont, the Triple Crown's final leg.

In *Think Twice*, Mauboussin melds a formidable roster of studies from the growing [field of behavioral finance](#) with more practical observations to make his points. As a result, the book provides a rigorous but accessible window into a booming area of study that's rapidly rising in prominence. Mauboussin, also an adjunct professor at Columbia University, has long studied the impact of psychology on investing -- though interest in the arena has recently expanded rapidly as the financial crisis has [shattered the previously prevailing](#) wisdom that financial markets are rational and self-correcting.

### Counterproductive Experts

*Think Twice* is replete with examples of thought-provoking experiments and commentary that shed light on the decision-making process. Mauboussin reports how conjuring up the last four digits of a person's phone number can influence a person's estimate of an otherwise unrelated item, like the number of doctors in Manhattan, by providing a psychological "anchor" for guesses. He explains how expert opinions are often counterproductive and why an anonymous Netflix ([NFLX](#)) algorithm might be better at recommending movies than a local video store clerk.

The investment world is littered with over-the-top books that promise to make investors a quick buck or offer easy formulas for picking winning stocks. *Think Twice* offers a welcome change of pace by focusing instead on how investors make decisions.

Mauboussin hopes that his observations can lead to better decision-making beyond just the world of investments. "They can be applied to medicine, sports, or any other walk of life," he says in an interview with *Daily Finance*.

### Beware Simple Readings of History

*Think Twice* does an outstanding job of highlighting research that shows the common pitfalls that decision-makers face. But the book is less convincing and more scattered when it comes to remedies for erroneous decision-making. Indeed, Mauboussin concedes that historical and statistical analysis can sometimes be disastrous -- for example, when investors are comparing situations that have superficial similarities but also key underlying differences.

Take the recent housing boom and bust that ended up throwing the economy into a tailspin. According to data collected by Robert Shiller of Yale University, during the 61 years spanning 1945 and 2006, [the maximum cumulative annual decline](#) in the average price of homes was a mere 2.84% -- in 1991. A simple reading of this historical data led to a false sense of comfort and a massive bubble, particularly as many homeowners borrowed against what they assumed would be the perpetually rising value of their houses.

Sometimes focusing on history can actually obscure commonsense, it seems. Says Mauboussin: "Rather than just looking at the statistical property of the outside world, sometimes it can be liking comparing apples and oranges." Still, if you're looking for insights about how to make better investing decisions, *Think Twice* should help you think more clearly.