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Emotional economic man: Calculation and anxiety in fund management

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ABSTRACT

Dominant theorisations of investment decision making remain firmly wedded to the notion of economic rationality, either as a postulate of how financial actors actually behave or as a normative ideal to which financial actors should strive. However, such frameworks have been developed largely without engaging financial market participants themselves. Based on 51 in-depth interviews with fund managers in various global financial centres, this article highlights a number of features of investment decision making that mainstream finance and behavioural approaches both fail adequately to describe. Drawing on psychoanalytic theory, it is shown how the inherent uncertainty of the investment process engenders a state of endemic anxiety among fund managers. This anxiety is managed via a range of mental defences, both conscious and unconscious. The importance fund managers place on meeting and putting trust in company management to 'perform' for them can equally be viewed as a means of alleviating anxiety rather than having any direct economic purpose. This article, furthermore, brings to light the crucial role that calculative techniques play in dealing with anxiety. Rather than constituting a means of restoring rationality or correcting cognitive biases, calculation can actually reinforce ego defences while simultaneously perpetuating the myth of *homo economicus*. Fund managers can be characterised as 'doing' but 'not doing' and 'knowing' but 'choosing not to know' and have to manage not only their clients' funds, but their own personal anxiety as well.

> "You know, this whole notion of efficient markets and economic man, I mean, I don't know what world they're looking at but it's not the same one that I live in." (interviewee 41)

1. Introduction

The belief that it is possible for fund managers to 'beat the market' is key to the existence and authority of the $37.2 trillion global asset management industry (ICI, 2016). This is despite considerable research showing that it is very difficult, if not impossible, for individual fund managers to outperform other fund managers or their benchmarks on any consistent basis after costs (e.g., Barras, Scaillet, & Wermers, 2010; Carhart, 1997; Fama & French, 2010; Gennaioli, Shleifer, & Vishny, 2015). Moreover, for those who do appear to outperform their peers, it is very hard to know whether they have done this on the basis of skill or luck (Jones & Wermers, 2011). Nonetheless, money managers are placed under enormous pressure to perform in an environment over which ultimately they have little control. In essence, they promote their funds to investors on the basis that they are able to do what cannot be done (Goyal & Wahal, 2008; Porter & Trifts, 2014). In a broader context, the whole asset management industry, its fund managers and their clients, can be viewed from one perspective as subscribing collectively to the idea that the uncertain future can be controlled and managed.

Our paper explores both how fund managers continue to do their jobs when they are expected to do what is not possible, and identifies the conscious and unconscious mechanisms they employ to deal with the anxiety that the outcomes of their investment decisions are essentially unpredictable. We hypothesise that *calculative rationality* – the deployment of formal calculative techniques and decision making processes – is an important means by which both fund managers, and asset management industry more

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broadly, are able to cope with uncertainty and help erect mental barriers against the reality that future returns are inherently precarious. Uncertainty, which cannot be quantified, is transformed into risk which is measureable (Knight, 1921) and the 'not-knowable' is thus seemingly avoided.[1]

We explore how fund managers make sense of what they do on a day-to-day basis. We do so in order to understand more broadly the nature of the – both conscious and unconscious – mental processes that underpin much of what takes place in financial markets. We draw on psychoanalytic theory to help explain our empirical findings. Whereas psychoanalysis originated in the clinical setting, psychoanalytic theory is now widely employed in the humanities, social science and management literatures. However, the application of psychoanalysis in the accounting and finance domains has been very limited to date. This is surprising as psychoanalysis "represents arguably the most advanced and compelling conception of human subjectivity that any theoretical approach has to offer" (Fotaki, Long, & Schwartz, 2012, p. 1105).

Consideration of what fund managers *actually do* in practice and *how* they make their buy, sell and hold investment decisions, as opposed to the outcomes of these, rarely enter into the research designs of either traditional finance or behavioural finance. Mainstream finance takes *homo economicus* largely as axiomatic, whereas behavioural finance presents it as a normative ideal. Crucially, here, 'calculation' is presented as a means by which investment professionals can reduce cognitive bias and ensure 'rationality' in their investment processes. However, in this paper we argue that the "calculative ideas" and "calculative devices" (Tan, 2014) employed by fund managers are equally used as a defence against the feelings of acute anxiety that uncertainty generates. An understanding of the nature of these processes is key to explaining the underlying paradox that the fund management industry represents. This paradox is, to a great extent, built on the idea that what is not possible can nonetheless be achieved. Were it to be formally acknowledged that investment professionals are not all-knowing, information processing machines who always succeed in making rational investment decisions, then the legitimacy of both their role and, more generally, that of the investment industry in its present form, might be called into question (e.g., Suchman, 1995), as might any wider faith in 'the market' as a means of efficiently allocating capital.

In this paper, we seek to identify the emotional aspects of the work of fund managers that are largely neglected by dominant theorisations. These are key to any understanding of how investment professionals mediate uncertainty and its associated affects. We argue here that fund managers 'know' but 'not know' (Steiner, 1985) and 'do' but 'not do'. In other words, they know on one level that they cannot beat the market, but on another level have to deny or repress this to allow them to continue to do their job, "turning a blind eye to [such] uncomfortable facts" (Steiner, 1985, p. 170). Drawing on 51 in-depth interviews with elite fund managers in various global financial centres, we illustrate how these individuals experience and manage continuous anxiety as they go about their professional activities. Further, we offer insight into the ways in which this emotional turbulence is dealt with at both an individual, as well as industry level. We find that this is often by resorting to calculative techniques which are frequently overridden, conflating risk and uncertainty and seeking relationships of trust directly with company management, *inter alia*, to delegate responsibility for their investment performance and thereby 'offload' their anxiety and feel better. Importantly, our findings suggest that investment professionals routinely employ a range of psychological defences to negotiate uncertainty and the mental 'pain' the associated anxiety leads to.[2] Importantly, this takes place within the broader context of an industry behaving as a *basic assumption group* (Bion, 1952) in collectively avoiding acknowledgement of the impossibility of doing what is conventionally expected of it. Calculation plays an important role in reinforcing, rather than dissipating, these defence mechanisms at all levels.

We contribute to the literature in a number of ways. First, we explore the emotional nature of the fund management task and how fund managers, and the investment industry more generally, deal with anxiety and their inability to distinguish skill from luck. Second, we describe the key role calculative techniques play in the fund manager's task, showing that these are not merely an attempt to help him/her perform better. Calculative techniques also provide a way of signalling expertise and authority, both to clients and to the fund manager him/herself. Being able to subscribe to a formal calculative schema, however flexible in practice, allows the fund manager to have faith that the future can be controlled so that he/she can continue to invest irrespective of actual investment outcomes.[3] Finally, we show how fund managers look to company management to alleviate their own anxiety through the establishment of trust. This need to trust helps explain the key role meetings with company management play in investment decisions, even though no price-sensitive information might be conveyed during these encounters (Barker, Hendry, Roberts, & Sanderson, 2012).

2. Theorising investment decision making

Dominant explanations of investment decision making are primarily drawn from mainstream finance theory. Mainstream finance is derived from neo-classical economics and assumes a world populated by *homo economicus*, or rational economic man: an individual who seeks to maximise his utility, which itself is typically reduced to simply wealth maximisation. Moreover, this individual is assumed to make perfectly rational decisions, possesses unlimited information processing power and holds preferences that are both predictable and stable (von Neumann & Morgenstern, 1953). By extension, markets are assumed to be efficient through the actions of these self-interested individuals, transacting together such that there are no opportunities to earn superior returns on a consistent basis.

In contrast to traditional finance, behavioural finance theorists and behavioural economists rely on the insights of cognitive psychologists in order to understand investor behaviour (Hirshleifer, 2015; Kahneman, Slovic, & Tversky, 1982; Shefrin, 2002). Broadly speaking, behavioural finance seeks to identify the myriad cognitive errors, or heuristics and biases, that individuals are assumed to be prone to. Hirshleifer (2015), a leading behavioural finance academic, for example, lists no fewer than 30 of these including overconfidence, overoptimism, regret, limited attention,

[1] Weick (1988), in fact, cherishes uncertainty and acknowledges the value of "an ongoing encounter with ambiguity, ambivalence, and equivocality; being part of a larger attempt to make sense of life and the world" (see also Czarniawska, 2005).

[2] There is a clear distinction drawn in psychoanalysis, as in the more general psychological literature, between anxiety, experienced in relation to unpleasurable and threatening internal, unconscious dangers, and fear which relates to consciously recognised realistic external threats (Auchincloss & Samberg, 2012, p. 18).

[3] In parallel,Tan (2014) shows how sell-side analysts use related devices in integrating corporate governance into their investment processes and views this predominantly in terms of analysts seeking discursively to establish their expertise. However, based on our research we would speculate whether this calculative process also serves to help the analyst alleviate his/her parallel anxiety associated with the very limited evidence that their investment recommendations are reliably related to future stock returns (e.g., Altinkilic, Balashov, & Hansen, 2013; Busse, Green, & Jegadeesh, 2012).