

Viewpoints

To follow the herd or not to follow the herd

The economy is in sad shape. The financial markets are in a state of turmoil. Most people are worried and wondering what they should do.

Those with money in the stock market are worried. Those with money in a savings account at a local bank are worried about the viability of the bank. Those who don't have any savings are really worried.

I will try to address one small question relating to the current financial crisis. Should you do what everyone else is doing?

There is a name for doing what everyone else does. It is called the herd mentality. The name derives from the behavior of cattle and other pack animals. Everyone has seen the ubiquitous stampede scene in cowboy movies. When should you follow the crowd and when should you go your own way?

In some cases, I ignore the crowd. Next Saturday, I will attend the final

Top of Utah Voices



Michael Vaughan

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Commentary

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game of WSU's football season. I know when I will leave my house. I know exactly where I will park. I know my way to the stadium; I have been there countless times. I will not alter my plans regardless of what the crowd is doing.

On the other hand, suppose that I was going to a game at UCLA, Penn State or Notre Dame. I have never attended a football game at these

schools. Yet, I am confident that I could drive to town and find my way to the game. Furthermore, I could do so without looking at a map or asking directions. What would I do? I would simply follow the crowd, and it would make perfect sense to do so.

On a Saturday afternoon, if 60,000 fans in a college town are moving in one direction, you can be sure that they are going to a football game.

Have you ever attended a religious service at a church you don't regularly attend? You probably figure out when to sit and when to stand fairly quickly. Have you ever been to a foreign country? You probably manage to avoid looking like a complete jerk after a day or two. What do you do? You simply do what everyone else is doing. You follow the crowd.

Following the herd makes sense if most of the members of the herd know what they are doing. On the other hand, following the herd is

mistake when the herd doesn't know any more than you.

During the 911 attacks, the Southeast Asia tsunami and Hurricane Katrina many people lost their lives because they did the same thing as those around them. What was wrong with this thinking? Those around them didn't know what they were doing. They had never been presented with a similar horrific situation before.

This brings me to the present financial crisis. On certain days, the Dow Jones Industrial Average is down 200 points at noon but finishes up 500 points in the final hour of trading. On other days it repeats this pattern in the opposite direction. Why? The answer is the herd mentality. Many investors, perhaps most, are uncertain. They don't know what to do.

As a result, they simply follow others. If others buy, they buy. If others sell, they sell. This can lead to

wild swings in the market. In recent weeks, the last hour of trading looks a lot like a stampede.

With present financial conditions, following the herd doesn't make much sense. Most of the people you would be following don't understand what is going on. I have yet to find a complete, cogent and believable explanation for the present financial problem.

Subprime mortgages are part of the problem. Complex financial derivatives are part of the problem. Illegal naked short selling is part of the problem.

Yet, I have not found a comprehensive analysis that connects the dots and explains the current financial situation.

In today's financial environment, it doesn't make sense to follow the herd. It makes more sense to keep asking hard questions and seeking valid information. Perhaps the best investment manual for 2009 is Ralph Waldo Emerson's *Self Reliance*.