SOLOMON'S PARADOX



PART ONE IN THE BEHAVIORAL FINANCE SERIES

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Whose advice should you trust? It sounds like a daunting question but research suggests that the answer is closer at hand than you might think. The advice you give yourself may be very sound as long as you can distance yourself from your situation. This so-called self-distancing can enable you to make much wiser decisions in both investing and life in general.

A Wise King but a Not-So-Wise Man

King Solomon, who ruled from about 970 BC to 931 BC, was said to be one of the wisest monarchs of ancient times. People reportedly traveled great distances to seek his counsel. One famous story recounts an argument between two women who both claimed to be the same boy's mother. King Solomon's solution was to call for a sword and split the baby into two. Upon hearing this, one woman said, "It shall be neither mine nor yours—divide it!" while the other cried out, "Give the baby to her! Just don't kill him!" The king declared the second woman to be the true mother.

However, the king was much less wise in dealing with his own affairs. He did several imprudent things, including taking hundreds of wives and amassing more wealth than ever needed. In addition, he failed at raising his son to become a just and fair ruler, which ultimately led to his people rebelling and the kingdom fracturing.

One's ability to reason more sensibly about someone else's problems than one's own is known in psychology as Solomon's Paradox.

Self-Distancing

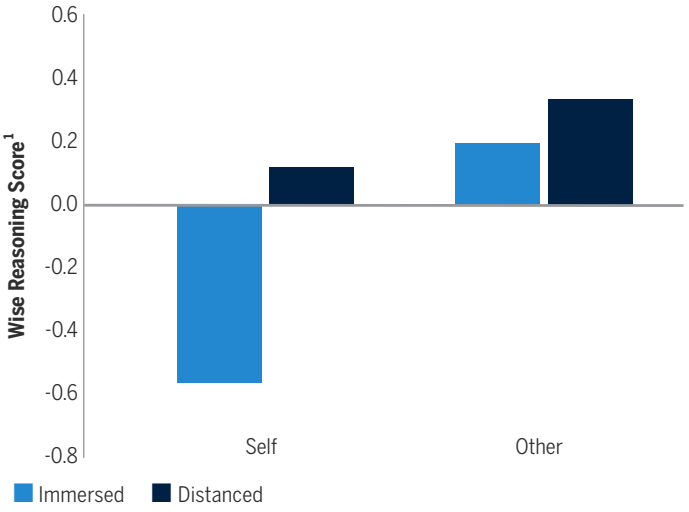
There may be a solution for Solomon's Paradox that can turn flawed thinking into astute counsel. Research shows that self-distancing or the act of removing one's own ego or circumstances from a situation may lead to better decision-making.

Dr. Igor Grossmann and Dr. Ethan Kross designed a reasoning experiment in which people were divided into two groups: the self and other groups. The self-group's reasoning skills were assessed in response to hypothetically discovering their significant others were unfaithful while the other-group's reasoning skills were assessed after a friend hypothetically discovered that a significant other had been unfaithful. The self-group scored much lower on the reasoning test than the other-group. Basically, "people are wiser when reasoning about others' problems than reasoning about their own problems."

Then the researchers further divided the subjects. They were instructed to think about the situation from two perspectives (Figure 1):

1. **Self-immersed:** first person reasoning such as why am I feeling this way or
2. **Self-distanced:** third person reasoning such as why is he/she feeling this way.

Figure 1: **A Distanced Perspective Improves Reasoning**



Source: Grossmann and Kross.

People who reasoned from a self-distanced perspective showed higher wisdom scores, regardless of whether the situation involved themselves or their friend. The conclusion is that simply distancing yourself from your own situation can help improve your reasoning ability.

Application to Investing

We believe the self-distancing principle applies to investing as well. Investors certainly have many biases that get in the way of making rational decisions. For example, when people consider buying or selling a stock, they may be influenced by a range of issues specific to their own experience, such as whether they have embedded gains or losses. This should not have any impact on a rational decision in a non-taxable account, yet time and again it comes into play.

Some investors who incorporate extraneous information into their decision-making process suffer from loss aversion, where it is harder to realize a loss than a gain, even when the prospective future returns remain the same. Others may be so caught up in a rising stock price that they fall victim to confirmation bias and ignore important fundamental developments or stop doing research altogether. Finally, some investors may even be biased by not having any exposure at all and join the investing herd at an inopportune time, driven by regret aversion, commonly referred to as fear of missing out. These biases are reasons individual investors often underperform the underlying asset classes in which they invest. For example, Morningstar estimates that the average investor in diversified U.S. mutual funds & ETFs under-performed the actual returns of those funds by approximately 120bps annually in the 10 years ending 2024.[2]

A distanced perspective may be a good way to combat investor biases that lead to underperformance. An outsider would likely be less affected by an investor's personal situation. Therefore, similar to the experiment in which utilizing third person reasoning delivered a wiser decision, self-distancing should be an effective tool to mitigate investment biases, refocus on objective facts, and create better performance results.

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[1] Grossmann and Kross, "Exploring Solomon's Paradox: Self-Distancing Eliminates the Self-Other Asymmetry in Wise Reasoning about Close Relationships in Young and Older Adults," May 19, 2014.

[2] Morningstar Mind The Gap 2025. The calculation compares aggregate dollar-weighted (IRR) returns based on fund cash flows with time-weighted (buy-and-hold) returns. **The performance data quoted represents past performance, which is not an indication or a guarantee of future results.**

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