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Taking finances personally

A country, or its government, can be criticized by economists for being too frugal and not spending all its budget to grow the economy, create jobs, and increase capital investment. Even for countries in dire economic straits, deficit spending is advocated to perk up the economy by bringing up the components of Consumption, Government spending, and Investment. Macroeconomics looks at employment levels and GDP growth and how these are affected by public spending or easing of interest.

The rules for personal finances are different.

Personal investment advisers who pop up on the internet as “influencers” or spiritual advisers can have programs on YouTube to guide followers on where to put their money. (Avoid Bingo.) Personal investment advisers, dealing with individuals and their spending habits, can resort to dramatic reactions to extravagant spending charged to the credit card (Where will you wear this fancy hat you bought online?)—scissors, please?

While macroeconomics is ruled by traditional theories that employ rational approaches assuming perfect information and mathematical models on optimization where, for instance, production should continue only until Marginal Revenue (MR) equals Marginal Cost (MR=MC), personal economics is ruled by psychology and how the brain (specially the unconscious) works with its emotional levers dealing with incomplete information and non-mathematical formulas.

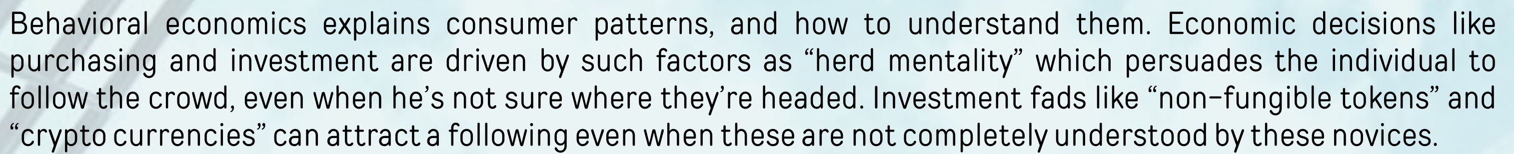
Is the “econ” (or rational economic man) of traditional economics different from the behaviorists’ “human” (the ordinary consumer) ruled by emotions, insecurities, and the unconscious brain?

Richard Thaler, one of the founders of behavioral economics, and a Nobel laureate for economics, postulates what he calls “mental accounting”. This psychological approach to personal finance looks at money not as a fungible amount that can be mixed up as a single interchangeable amount to be used for any purpose.

Mental accounting segregates money in different categories, like budget for tuition of children, utility bills, dining out, vacations, emergencies, and other “envelopes”. Even the source can differentiate the cash and what it can be used for. Bonuses, tax refunds (not too often in our country) and maybe a lotto jackpot received by unidentified winners are treated differently from regular income.

Thaler gives the example of a casino goer. The money he wins early in the game is categorized as “house money”. The casino goer pockets the money he brought with him, and then plays only with his winnings (at first). He can be reckless in gambling with the “house money” and may eventually lose it. Still, this gambler doesn’t feel a loss aversion as that money won earlier was not really considered owned. The casino doesn’t mind either, especially when the gambler afterwards needs to dip into the money in his pocket, this time feeling the real loss. And the use of chips rather than cash makes the gambler forget that what he is putting on the table is real money.

The stock market is sometimes compared to a casino. (It’s very different.) Still, the emotional detachment to gains and losses apply. Do paper profits or losses from stock price fluctuations count as increases or decreases in wealth? It’s only when astock is sold that the profit or loss realized.



Behavioral economics explains consumer patterns, and how to understand them. Economic decisions like purchasing and investment are driven by such factors as “herd mentality” which persuades the individual to follow the crowd, even when he’s not sure where they’re headed. Investment fads like “non-fungible tokens” and “crypto currencies” can attract a following even when these are not completely understood by these novices.

Issues of personal finances affect not just the lowly clerical class or the beneficiaries of inward remittances but also those with extensive wealth. They spend on different things and maybe their minds work differently as the wealth increases.

The lesser-known Parkinson’s Law states that “expenses rise to meet income”. Someone who moves to a higher paying job will immediately upgrade his lifestyle and start acquiring durable goods and property. Even the already wealthy need to manage their personal finances as they increase their borrowing limits and ramp up their disposable income.

In taking finances personally, emotions and the unconscious part of the brain need to be recognized for where they lead us. The rational mind eventually takes over in analyzing what happened…even in hindsight.

Philequity Management is the fund manager of the leading mutual funds in the Philippines. Visit www.philequity.net to learn more about Philequity’s managed funds or to view previous articles. For inquiries or to send feedback, please call (02) 8250-8700 or email ask@philequity.net.