



AN EXECUTIVE SUMMARY OF

# THINKING, FAST AND SLOW

by Daniel Kahneman

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## Who is Daniel Kahneman

Daniel Kahneman, born on March 5, 1934, is an Israeli-American famous physiologist. He is most respected for his research regarding the cognitive biases of the human mind. His findings are profound and challenge the very assumptions made by the human race. He has received several accolades for his work and was also listed by The Economist as the 7th most influential economist in the entire world. As a psychologist who won the Nobel Prize in Economics in 2002, Kahneman's books have been devoured by millions of people all over the globe. If you're interested to know more about his work, read the book: **Thinking, Fast and Slow**.

## Preston and Stig's General Thoughts on the Book

In his own humorous way, Kahneman's starting point is that all humans are constantly making mistakes and when he combines that idea with stock investing, well, what more can you ask for? Kahneman suggests that since human nature is highly illogical, people can't beat the stock market. To some extent, that makes a lot of sense on the surface. As one thinks deeper – avoiding the potential “fast thinking” trap – one might uncover that Kahneman's claim is a paradox of itself. Although the Market is a zero sums game, my main takeaway from this very well written book is exactly the opposite: You can beat the market, because humans make mistakes. Whether you agree with Kahneman or myself, I think everyone will enjoy the countless examples he provides, not only from stock investing but from numerous studies and personal experience that are both hilarious, thought-provoking, and everything in between.

## Preface

This book takes the reader on a spectacular journey about the human mind's biases. Kahneman states that we, as humans, tend to assume things even when we don't have a lot of information about it. This is known as heuristics and Kahneman explores the theory throughout the rest of the book. We have two systems namely System 1 and System 2 and while System 1 is emotional and instinctive and fast thinking, System 2 is cautious and logical and is thinking slow. Essentially, this book will show the reader how to think slowly, without cognitive biases.

## Part 1: Two Systems

The first part contains 8 different chapters and explains 8 types of heuristics. In this section, Kahneman explains that our brains have two characters namely System 1 and 2. While System 1 operates effortlessly and automatically (eating, driving and performing other activities), System 2 operates cautiously and prevents us from jumping into conclusions. Both the systems could have a conflict between themselves and while System 1 could be inaccurate and performs actions based on heuristics, the System 2 evaluates the heuristics. The actions performed by System 1 are involuntary and we can't really switch it off, but System 2 has a lot more control. System 2 can gradually change system 1, and it's a process that we can force to speed up if we want to if we are determined.

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Further, Kahneman explains attention and effort where he explores the advantages of thinking slow. We usually don't think slowly because it's a lot of work and laziness is ingrained in our systems. For example, when we want to buy something, we just go ahead and do it without bothering to think too much; however, when we think slowly, we tend to make detailed lists of what we really want to purchase.

Often, we let System 1 take over because it's tough to concentrate on something and we take the path that offers minimum resistance. It can also feel like it's almost impossible to exert self control when we are tired or stressed. This also explains why it's dangerous to divert your attention – for instance, driving – to anything else while doing something important. Since mental tasks require effort, so we take the easy route and let System 1 take over.

Kahneman explores “Priming”, and explains how we associate things depending on our subconscious and conscious. Our exposure to these elements helps us make associations immediately. For example, if you're into fitness, and are asked to fill in the blank for F\_T, you might say it's FIT, but if you're not, you could say FAT. Our exposure often affects the way we think.

Kahneman also explains another heuristic, known as the Cognitive Ease, where we tend to believe that actions that are easy to do are true when compared to anything that isn't. This applies to advertisers, teachers and marketers, and people believe them because they are familiar. This also makes us believe in lies if we hear it often. Furthermore, the human mind associates circumstances or events with each other to derive a meaning. When things don't occur as we expected, we often convince ourselves with new stories and relate it to fate, destiny or divine intervention.

Another heuristic, which is the confirmation bias, is our tendency to search for confirming proof for beliefs. While System 1 is instantaneous and doesn't consider anything else, System 2 makes us slow down and think; however, System could be lazy although it's in charge of making us question things. We are also prone to fall for the halo effect where we start liking everything about a person, and this could lead us to ignore the negative attributes of the person and later ignore the positive effects too. It hinders our ability to make judgments. As humans, we rely on System 1 that's intuitive rather than relying on facts that are accurate. We are also guilty of substitution where we replace tougher questions with simpler questions because they are difficult to answer.

## **Part 2: Heuristics and Biases**

In this section, Kahneman explains how statistics can be often ignored. He laments about how we give more credence to small samples instead of focusing on larger samples. This is because of the System 1 that makes people believe that smaller samples are as good as larger samples. Thereby, most people tend to quickly make decisions although it's based on data that's often insufficient.

Many businessmen and entrepreneurs develop over confidence that overrides any doubts projected by System 2. While System 1 constructs believable stories from insufficient data, System 2's responsibility is to doubt it, question it and arrive at the right conclusion; however, since such a task is arduous, we quickly accept stories and make associations or connections for even random incidents although some incidents truly don't have a relevant answer.

Kahneman describes the anchor effect where our subconscious automatically makes inaccurate estimates just because it has heard different quantities earlier. For example, if you want to buy a property, it seems to be highly priced if the price is raised from \$400k to \$500k; however, it suddenly seems like a great deal at a low price if you're told that the price has been reduced from \$600k to \$500k.

Our mentality also has the habit of over or underestimating the frequency of events based on the ease of the answer instead of relying on statistical calculations. For example, if you're a person who's had a near brush with death, you're likely to overestimate any dangers, but if you're someone who's lived a safe life, you might underestimate any potential dangers lurking around you.

While we overreact to minor problems when we hear about too many negative incidents, we also evaluate everything based on how much it resembles other things we like. This leads to the conjunction fallacy where our intuitions accept anything that's believable but improbable over things that are probable but implausible.

Another flaw that can be disastrous is when we believe casual interpretations instead of checking the data or facts. We try to make associations with random events and try to find relevant causes when none exist. Again, System 1 overtakes System 2. System 1 feeds our overconfidence and we act on an impulse without checking if we are prone to errors. If an individual learns to tame his intuitive predictions, he will not allow his overconfidence to take over his mind..

### **Part 3: Overconfidence**

In this section Kahneman outlines seven more heuristics and it's mostly to do with the overconfidence of a human being. He explores our narrative fallacy where people tend to create believable flawed stories depending on incidents from the past and thereby use it as a foundation for their views on the future. This leads to a strong illusion where people think that they understand their past and automatically feel that their future is predictable; however, taking decisions based on intuitions and premonitions can create an illusion and although we feel that the future becomes clear when we recognize our past, we don't really comprehend the past as much as we think we do.

One could also get drowned in illusions due to overconfidence. Sometimes, people are so overconfident that they cling to their ideas even when they are proved otherwise with concrete facts. Such illusions can only lead to errors in judgment because one tends to over value his abilities and brilliance more than he's supposed to. Going further, Kahneman explains how people make judgmental errors while relying on their intuitions instead of relying on statistics. According to him, intuitions simply mean that we know something although we aren't sure how we know it. For us humans, our intuitions are so powerful and familiar that we quickly jump to conclusions rather than understanding that intuitions are just patterns that help us recognize events in our life.

Another fallacy most people suffer from is to instantaneously believe so called 'experts' who dispense advice with such confidence that there's no doubt about what they're saying. However, Kahneman argues that it's not recommended to simply believe experts because they ignore information they aren't aware of. Therefore, if an expert is not from an area that displays predictability regularly, and hasn't had a lot of practice, he could easily mislead people.

Kahneman cautions businessmen, investors and entrepreneurs against taking up risky projects without sufficient planning. For example, if you want to start a business, you need to do your homework before you set shop. Your confidence and optimism shouldn't lead you to make errors that can be devastating for you later. In many cases, people also forget the luck factor, and according to the optimistic bias, we ignore many factors that could hinder our progress. For example, if you start a business without bothering to check your competition, and other elements that are crucial for you to run your business, it could be very risky for you.

## **Part 4: Choices**

In this section, the readers are provided with an opportunity to get a glimpse of Kahneman's work that led him to the Nobel Prize. He describes how he (along with Tversky) conducted an in-depth research about prospect theory and risk aversion to identify how humans weigh risk and take decisions. Interestingly, when presented with positive and negative data, the human brain remembers only the negative aspect although both the factors are equally divided. For instance, if a doctor tells us that you have a 50% chance to live and a 50% chance to die, you're prone to worry about your death although your chances are equally divided.

He also explains the loss aversion theory wherein we work harder towards avoiding losses rather than achieving gains. One reason to do this is when we underestimate our capabilities. When businesses try to avoid their losses instead of focusing on potential gains, a huge imbalance takes root in the system. This kind of mindset could also lead to risk aversion to such an extent that we completely avoid any kind of gamble. According to Kahneman, this narrow thinking could also make people avoid gambles even when they are certain to make money. Here, System 1 overtakes System 2 completely by paralyzing our ability to think clearly even when there's easy money to be made.

Investors who have pushed money in stocks are jubilant to sell stocks that earn money; however, they are hesitant to sell stocks that are losing because it implies defeat. Kahneman declares that such a mindset is irrational because investors are likely to make more money by holding on to the winning stocks while selling the ones that are losing. The risk of failure is ingrained so deep in our brains that we often make the mistake of investing in bad businesses, cling on to marriages and relationships that have no chance of surviving, and also force ourselves to hang on to careers that evoke no interest in us.

Sometimes, we fear the risk of starting something and regretting it later. Regret is a powerful emotion and most people are so familiar with it that they turn their back towards any decision that could lead to regret. However, the problem occurs when we underestimate how powerful regret could be. We are tempted to make bad decisions, only to regret them later, and it's also true that it hurts more than we actually imagined.

## **Part 5: Two Selves**

In this section, Kahneman talks about his current findings. He also gives us a lot of insight about our "remembering self" and "experiencing self". He laments that we are prone to ignoring these two elements in our lives. Kahneman asserts that our remembering self overtakes the experiencing self. For example, if you go take a vacation for a month and although you enjoy for 29 days, if your experience goes bad on the 30<sup>th</sup> day, your memory will only choose to remember the entire vacation as a bad incident. This, again, is a cognitive illusion where we substitute our confusing experiences with our memory and thus believe that our experience has been ruined.

Kahneman also explains how this leads to another heuristic, which is known as the peak end rule. Here, the entire experience seems to have a lot of importance rather than that one incident that went wrong. Therefore, one bad incident could ruin the entire experience for us, even if it has been enjoyable. We even ignore the duration of a pleasant or unpleasant experience since it doesn't seem to be as important as our memory that recollects how pleasurable or painful our experience was.

Kahneman summarizes the concepts of heuristics in an amazing manner at the end of the book. He concludes by saying that it's absolutely absurd how people can embrace pain and suffering that extends for longer periods of time just because it ends pleasantly. On the flip side, accepting suffering for shorter periods of time even if it ends horribly seems like an ideal option.

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