

Why we are all hard wired to be bad investors

by Gary Moglione

Investing our savings is an extremely important part of life that will have a strong influence on retirement, home ownership and the quality of our lifestyle. Therefore, you would expect us to have evolved to be efficient investors. Unfortunately, we are hard wired to be bad investors as many of our natural instincts force us to fall into a number of behavioural traps that result in poor investment returns.

The first one is herd mentality. This becomes more prevalent at points in the cycle when retail investors are highly active as investment tips get passed on in workplaces, pubs and dinner parties. Everybody has heard stories of people getting rich investing in Bitcoin or technology stocks that has made them motivated to get involved. A small number of high-profile stocks have posted stellar returns in recent years. As a result, valuations have been pushed up ever higher. Higher valuations should spark caution when investing but the reverse actually takes place. People talk about their gains to friends and family sparking more interest in a stock. This causes the share price to rise even further detaching it from intrinsic value. We have witnessed this many times before with the 'nifty fifty' period in the late 1970's and the tech boom in the late 90's. Dare I say we are in a similar environment at the moment.

Another negative behavioural trait is recency bias. This one has been very important in 2020 as a result of the COVID crisis. The global lockdowns created a unique environment of share prices for technology platforms rocketing while those of many businesses that require some form of human contact declined to extreme lows. This was a unique environment but logic tells you that the lockdowns could not be applied forever and historically pandemics, however extreme, eventually dissipate and we return to normality. Rather than taking a long-term view and taking advantage of the low valuations people invested as if the lockdown environment would persist forever. Just months later, as the vaccine rollout moves forward, we are now seeing a reversal of 2020 trend with tech leaders falling and the COVID impaired stocks rallying strongly. By going against their instincts and taking a long term more contrarian view in 2020 investors could have made spectacular returns

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selling the best performing stocks and buying impaired stocks at incredibly low valuations.

How do we keep these biases out of our decision making when investing? There is no clear answer to this but being conscious of our weaknesses is one step. A robust and well-developed investment process keeps your thinking focussed on the fundamentals. The ability of others on your team to challenge your thesis is also important to remove the blinkers and the potential for confirmation bias (i.e looking for evidence to support your initial instincts in your analysis).

I found that Daniel Kahneman's book "Thinking Fast and Slow" is useful in recognising how your brain makes decisions and how the basics can be applied to investing. The book outlines two types of thinking.

Type 1 - Fast, automatic, frequent, emotional, stereotypic, unconscious

Type 2 - Slow, effortful, infrequent, logical, calculating, conscious

Type 1 thinking is clearly impulsive and emotional. These are two traits that do not work well when investing. Type 1 thinking is used in around 98% of our decision making¹ and does a fine job of both protecting us from danger and allowing us to go about our daily routines. However, type 1 thinking will encourage you to buy high because everyone else is and sell low because the market dislikes the stock, making you fearful of further losses. When thinking about investments it is important to engage your type 2 thinking. Make your decisions slowly and for the long term. Ensure they are backed up with sound and detailed research rather than simply a fear of missing out. Focus on the fundamentals and make your decisions based on logic not emotion. This is not a formula for guaranteed investment success but it will help you to be more self-aware and to avoid some of the behavioural traps we are pre-programmed to fall into.

¹<https://suebehaviouraldesign.com/kahneman-fast-slow-thinking/>

Market Focus

- » Global equities rose 2.9% last week
- » OECD revises up 2021 global growth forecast to 5.6%, an increase of 1.4 percentage points from the OECD's December forecast
- » Brent crude fell -0.2% last week to \$69.2 a barrel
- » Gold rose 1.6% to \$1727.1 per ounce

US

- » US equities rose 2.7% last week
- » President Biden signed into law the \$1.9tn American Rescue Plan Act, following its passage in Congress. The bill includes direct \$1400 payments to most Americans, an extension of jobless benefits, and a child tax credit
- » Nonfarm payrolls in February increased by 379k against 200k expected, taking the unemployment rate down to 6.2%
- » Wholesale inventories rose 1.3% month-on-month in January
- » Headline CPI increased to 1.7% in February from 1.4% in January, in line with market expectations.
- » The weekly unemployment claims report showed that over 20 million Americans were collecting unemployment checks in late February

Europe

- » European equities rose 3.9% last week
- » The ECB said they expect purchases under the Pandemic Emergency Purchase Programme (PEPP) to be conducted at a significantly higher pace over the next quarter than during the first months of the year
- » The EU will propose 'passports' for those who have taken EU-approved vaccines
- » Factory orders in Germany increased 1.4% month-on-month in January, above market forecasts of a 0.7% rise
- » Italy is set to impose another national lockdown over the Easter weekend to combat growing numbers of coronavirus cases.
- » The EU is bringing in new legislation, called the Sustainable Finance Disclosure Regulation, which contains new reporting obligations on the sustainability of financial products
- » Germany's exports rose 1.4% month-on-month in January after an upwardly revised increase of 0.4% in December

UK

- » UK equities rose 1.8% last week
- » Bank of England Governor Andrew Bailey signalled increased concern about the possibility of rising inflation, though he said that interest rates were not about to be raised
- » The OECD revised its 2021 growth forecast up to 5.1%, an upward revision of 0.9% compared to December's forecast.
- » Economic output shrank -2.9% in January
- » Exports from the UK to the EU, excluding precious metals, fell -40.7% from December, while UK imports from the EU fell -28.8%

Rest of the World/Asia

- » The benchmark Global Emerging Markets index returned 0.7% last week
- » Japanese equities rose 2.9% in the week
- » China's exports were up 60% year-on-year on a year-to-date basis in February
- » China launched a digital covid-19 vaccination certificate for cross-border travel

Asset Class / Region	Currency	Cumulative returns			
		Week ending 12 March	Month to date	YTD 2021	12 months
Developed Markets Equities					
United States	USD	2.7%	3.5%	5.2%	60.9%
United Kingdom	GBP	1.8%	4.5%	5.6%	30.9%
Continental Europe	EUR	3.9%	4.4%	5.6%	48.6%
Japan	JPY	2.9%	4.6%	8.2%	50.5%
Asia Pacific (ex Japan)	USD	0.3%	0.2%	5.1%	55.1%
Australia	AUD	0.9%	2.0%	3.8%	31.1%
Global	USD	2.9%	3.0%	4.6%	60.5%
Emerging Markets Equities					
Emerging Europe	USD	4.8%	6.4%	5.3%	48.8%
Emerging Asia	USD	0.1%	-0.2%	5.1%	58.5%
Emerging Latin America	USD	2.3%	4.7%	-5.3%	40.9%
BRICs	USD	0.0%	-0.1%	3.4%	51.0%
China	USD	-0.7%	-2.2%	3.9%	49.5%
MENA countries	USD	2.9%	3.3%	8.3%	38.2%
South Africa	USD	2.7%	5.5%	11.6%	58.7%
India	USD	1.3%	5.2%	8.2%	61.9%
Global emerging markets	USD	0.7%	0.8%	4.6%	56.0%
Bonds					
US Treasuries	USD	-0.6%	-1.0%	-4.4%	-3.6%
US Treasuries (inflation protected)	USD	-0.2%	-0.7%	-2.3%	8.3%
US Corporate (investment grade)	USD	-0.6%	-2.2%	-5.1%	5.3%
US High Yield	USD	-0.1%	-0.2%	0.5%	17.9%
UK Gilts	GBP	-0.7%	0.0%	-7.2%	-7.0%
UK Corporate (investment grade)	GBP	-0.5%	0.0%	-4.5%	4.4%
Euro Government Bonds	EUR	0.3%	0.4%	-2.2%	0.7%
Euro Corporate (investment grade)	EUR	0.0%	0.2%	-0.7%	3.7%
Euro High Yield	EUR	0.3%	0.3%	1.4%	14.6%
Japanese Government	JPY	-0.1%	0.7%	-0.6%	-2.2%
Australian Government	AUD	0.9%	1.4%	-3.8%	-3.8%
Global Government Bonds	USD	-0.2%	-1.1%	-4.8%	0.3%
Global Bonds	USD	-0.2%	-1.1%	-4.0%	3.4%
Global Convertible Bonds	USD	1.5%	-1.3%	1.6%	36.8%
Emerging Market Bonds	USD	0.0%	-1.3%	-6.7%	6.4%

Asset Class / Region	Currency	Cumulative returns			
		Week ending 12 March	Month to date	YTD 2021	12 months
Property					
US Property Securities	USD	5.1%	5.0%	9.2%	29.6%
Australian Property Securities	AUD	-0.4%	2.4%	-4.9%	-0.3%
Asia Property Securities	USD	1.4%	-0.5%	6.2%	10.6%
Global Property Securities	USD	3.3%	2.6%	5.2%	23.9%
Currencies					
Euro	USD	0.3%	-1.1%	-2.3%	6.8%
UK Pound Sterling	USD	0.7%	-0.2%	2.0%	10.3%
Japanese Yen	USD	-0.7%	-2.2%	-5.3%	-3.4%
Australian Dollar	USD	1.2%	0.5%	0.9%	22.1%
South African Rand	USD	2.9%	1.5%	-1.8%	9.7%
Swiss Franc	USD	0.2%	-2.0%	-4.7%	1.8%
Chinese Yuan	USD	-0.2%	-0.5%	0.3%	8.0%
Commodities & Alternatives					
Commodities	USD	0.1%	1.8%	15.9%	40.3%
Agricultural Commodities	USD	-0.1%	-0.3%	9.3%	43.8%
Oil	USD	-0.2%	4.7%	33.6%	108.4%
Gold	USD	1.6%	-0.4%	-8.8%	8.3%
Hedge funds	USD	0.7%	0.3%	1.8%	13.4%

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