

# INVESTORS AND THEIR DECISIONS (7)

A series of articles, this one being the 7th and last one, addressing investors and their decisions. In particular, whether factors other than rational considerations play a role in the investment decision process and if so, what the practical consequences and applications are. This is the third article addressing managing these other factors (biases). This is the last article the author writes for OB Golf & Leisure Magazine. He thanks the editors for enabling him to share perspectives and ideas about personal finance with their readership and wishes the readers success on their paths of investing.

## DATA INVESTORS NEED TO PUT IN THEIR “COMPUTER”

In my previous 6 articles I have tried to give answers to the startling fact that investors underperform the markets with several percentage points p.a. Aiming to explain this worrying fact, I introduced readers to the perspectives of Behavioural Finance, which suggests that people (investors) are prone to

biases in their decision making progress- both cognitive and emotional biases.

For perspectives about possible remedies, I introduced readers to the workings of our brains, as put forward by Daniel Kahneman (1). I applied Kahneman’s concept of the fast and slow part of our brains to the investor decision

making process and suggested investors use the slow part of their brain as a remedy against bias-prone investment decision making.

I then discussed how a theory, successfully used in elite sport, also can be applied to investors in their decision making process: the theory of Dr Steve Peters (2). I specifically

addressed how investors can manage their “Inner Chimp”.

In this concluding article to the series, I will discuss one more action investors could take to promote the making of sound investment decisions. This argument still follows the ideas of Dr. Steve Peters: to put “sound data” in the Computer part of our brain.

**Summarizing Dr. Peter’s perspective about the functioning of our brain, simply put (3), there are three mechanisms with different characteristics working in our brain:**



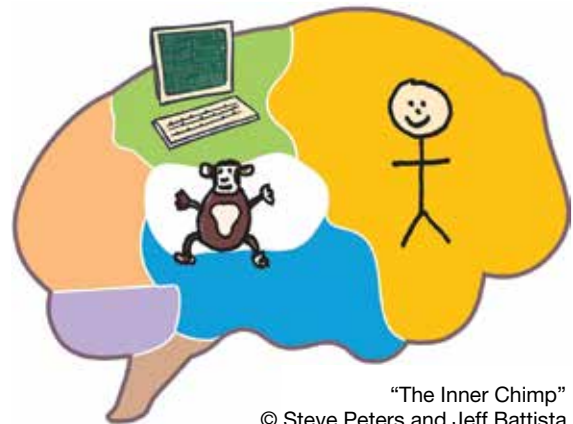
1) The Chimp which is emotive and irrational;



2) The Human which has self-control;



3) The Computer which thinks and acts automatically, using programmed thoughts.



Key is the inter phase between these 3 parts. Particularly challenging is that these three parts react to what comes to us with different speeds. As I mentioned, in a previous article (again, according to Dr.Peters’ theory), the Chimp in our brain reacts 5 times faster than the Human (4).

According to Dr. Peters' theory, the Computer has, in fact, the fastest speed of all three: 20 times faster than the Human and 4 times faster than the Chimp. So, it is essential that this Computer contains "sound data". Naturally, this

raises the question- what qualifies as "sound data"?

Readers when googling "investment wisdoms" will find several interesting notions about investing. These are often contradictory and more worryingly, either directly

or indirectly promote the idea that amateur investors can outperform the market. So, they do not qualify for the "sound data" I am recommending.

This author's 10 suggestions about "sound

data" takes to some extent a leaf of John Bogle's 10 lessons (5), but takes a very different perspective on the role of advisers.

Note: John Bogle is the founder of the Vanguard Group.



## The critical 10 Key Data investors need to store in their Computer are:

### 1. INVESTING AND SPECULATING ARE DIFFERENT ACTIVITIES

When investing you aim for returns over the long term (minimal 5 yrs plus), by participating in the long term returns capital markets offer.

When speculating you aim for returns in a day, week or month, aiming to profit from specific opportunities.

These are both legitimate activities, but different, and need to be distinguished from each other.

### 2. MARKETS ARE THERE TO PARTICIPATE IN, NOT TO BEAT THEIR RETURNS

Trying to beat the market, or trying to find managers who do, is not the purpose of investing. This is a "losing game" anyway (6). Investors invest to meet personal goals and when materializing returns (net of costs) close to market returns they do great.

### 3. ASSET ALLOCATION IS THE KEY DRIVER

Asset allocation (between asset classes such as

stocks, bonds and alternative investments) is key and the driver of performance. Decide on major adjustments, not because of market conditions, but because of changes in your investment goals.

### 4. RETURN AND RISK GO HAND IN HAND

This is stating the obvious...or is it? Are you familiar with: "getting maximum returns with minimal risk"? This is a mythical notion that does not equate to "sound data". There is no escaping this fact: risk and return go hand-in-hand.

### 5. TRENDS COME AND GO. WHEN DIVERSIFIED, AT TIMES, TRENDS WILL GO YOUR WAY, AT TIMES THEY WILL NOT

In a diversified portfolio, it is inevitable that some parts will do well and others not.

Anticipating trends consistently is impossible. Following trends incurs costs and most times you will be too late.

### 6. BE AWARE OF REVERSION TO THE MEAN

What's hot today isn't likely to be hot tomorrow. Investments invariably tend to reverse to the mean (7).

### 7. TIME IS ON YOUR SIDE

Take advantage of compound interest (8). Take both the large upswings as well as downswings with a healthy measure of salt.

### 8. HAVE REALISTIC EXPECTATIONS

The goal of investing is not to get rich quickly. For USD investors, numbers mentioned by John Bogle, can be a guideline: 7.5 percent annual return for stocks and a 3.5 percent annual return for bonds (9). Remember: it is only a guideline.

### 9. PAY ATTENTION TO COSTS BUT ACCEPT GRACEFULLY THAT ADVICE COMES WITH A PRICE

Costs matter. However, good advice or investment

management will help you get the satisfactory returns you are looking for and is worth the price. Our bias prone decision making process is as much an enemy as costs are.

### 10. STAY THE COURSE

The secret to investing is there is no secret (10). This is the "Zen" of investing.

When you own a well diversified portfolio, investing in the various asset classes, well selected with an eye on costs, you have the optimal investment strategy. Discipline is best summed up by staying the course (11).

Putting "sound data" in the Computer part of our brains, is not a one time action for investors but a continued process. Keep reverting to the 10 listed in this article; it may help keep the Chimp at bay, with that the biases and so enable investors to get the performance of their investments they are looking for.

Notes:

- (1) "Thinking Fast and Slow" by Daniel Kahneman, Penguin Books, 2012  
 (2), (3), and (4) "The Chimp Paradox, The Mind Management Programme for Confidence, Success and Happiness" by Dr. Steve Peters, Vermillion, an imprint of Ebury Publishing, a Random House Group company, 2011  
 (5) Allen Roth, discussing "The Clash of the Cultures: Investment vs. Speculation" by John Bogle and quoting Bogle's 10 rules for Investing, in Money Watch 22 August 22  
 (6) From: "Winning The Loser's Game" by Charles Ellis, The McGrawhill Companies, 5th edition 2010  
 (7), (8),(9),(10),(11) All part of John Bogle's 10 lessons, as discussed by Allen Roth, see (5)



Frank van Lerven CFP®

CFP® Professional  
 franler@attglobal.net