S Johnson Wealth Management LLP

Investment Specialists

Risk & Return - Balanced Investing

Investment News

November 2018

Introduction

Fear and Greed

In this edition we look at one of the main drivers of investment performance. The fancy name for this stuff is now 'Behavioural Finance' (previously known as fear and greed); how this works to affect investor decisions I discuss below. I also welcome our new partner and for once pay passing attention to 'Fred in the pub'.

Market Commentary

FAANGS have had some teeth drawn but still have bite. UK faces skilled labour shortages with economy at closest to full employment since the early 70's.

Psychology of Investing – Some Considerations

Emotion and Investment

Computer algorithms are increasingly used to analyse markets but they cannot (yet) predict human emotional responses. Fear and greed are still major factors driving markets closely followed by the four horsemen of the apocalypse, the press, herding, ignorance and Fred (Fred is the 'expert' in the pub).

Our brains sections have different functions and medical science can tell which bits we are using at any one time by looking at changing blood flow within the brain. The two main parts that affect our investment decisions are the emotional primeval bit (freeze, fight or flight – chimp part) and the 'human' bit – the logical analysis 'Spok' like part. The first part was essential for keeping us alive many years ago and the second is responsible for our development; let us look at the interaction between the two parts in more detail:

Loss Aversion

Down is much worse than up. Emotionally people experience a level of emotional pain when they lose money that is about twice as intense as the pleasure they experience when they make money. This may not come as a surprise but it explains why market falls are extended even when conditions have improved – people remain frightened.

Diminishing Sensitivity

At one time I used to get terribly hurt and angry when my kids raided my beer fridge and viewed it as a personal attack. Now I am completely inured to it (and hide my beer when possible). In a financial context, as people become wealthier and more experienced in financial matters they are less likely to react in a knee jerk fashion to market volatility – they move from chimp to human. The more financially knowledgeable you are the more likely you are to take more risk. This is interesting because the

average level of financial knowledge in 2018 is now much higher than was historically the case. Of course for those with little investment experience - refer point above.

Reference Point Theory

This is to do with what we expect or feel entitled to receive. Part of our job as advisors is to 'manage expectations'. This is of course tricky because as an adviser I (generally) want people to invest and sometimes must tell them that their expectations are unrealistic. We normally start off by telling prospective clients that there will be some years when we review their holdings and we will be reporting losses, if we do not feel people are taking this on board we will not act for them.

Inflammability

This is not a real word but it should be. I had an uncle whose favourite saying was 'nobody is inflammable….' If we are to talk about soft facts like emotion vs market effect then I do think that human fallibility should be brought into consideration.

SUMMARY

The computers do not yet rule the world, not at least until artificial intelligence manages to completely predict varying emotional responses. I am interested in investor emotions since the action of individual investors affects others – and can give rise to 'herding' and other reactions, which in turn drives markets. Think about how you feel about stuff and how your views and actions have changed – because most humans have a lot in common. We as advisors have to allow for this stuff when determining client risk profiles – one of the most important parts of our job – and typically for less experienced investors we will wind back risk levels a bit to allow for human responses, both those of markets and our clients. In this context I often try to think like a normal person, rather than a financial adviser.

'Financial Medical'

Our offer of a free review of your existing investments or a strategy report for recipients of this newsletter is still open; call us if you would like a chat.

Help us, please -

Many of you will remember my views on investing in FANGS (Facebook, Amazon, etc). On the basis that if you can't beat them… We would be very grateful if those of you who have Google accounts could give us a (hopefully nice) Google review since we are seeking to expand - just go onto Google and find our business and review it please. Many thanks to those of you who have already left reviews for us.

And finally…

Please continue the feedback – telephone us or send an email. In the next edition I look at crypto currency – Bitcoin and the rest.

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p.s.

Martyn, having passed his exams, has now been made a partner in the firm. I have been studying him closely for over 25 years now and I have confidence in his financial progress, in addition - and vitally - I trust him completely (except of course around my beer fridge).

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p.p.s.

This is probably the only time that you should pay some passing attention to 'Fred in the pub'. Fred often disappears for weeks at a time just after he makes the mistake of nailing his colours to the mast (just before his ship sinks) and only reappears when amnesia has set in. Fred however can be useful as a barometer of herding.

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p.p.p.s.

Chinese banks are now using psychology via micro-expression technology on customers asking for loans to detect fraud. As an ex-Customs Officer I wish them luck with this – lots of people going through the

green channel look guilty because of their nervousness but are in fact innocent – likewise it's stressful enough asking for a loan without this added level of surveillance.

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