A SAFAL NIVESHAK SPECIAL REPORT

Exclusively for Subscribers of *The Safal Niveshak Post*

Investor, You Failed the Psychology Test!

Results of Safal Niveshak's Investor Psychology Survey

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Foreword

"A human being is a dark and veiled thing; and whereas the hare has seven skins, the human being can shed seven times seventy skins and still not be able to say: This is really you, this is no longer outer shell."

This is what the noted German philosopher and poet Nietzsche said, and this is what the Austrian neurologist Sigmund Freud agreed – we are ignorant of ourselves!

And the biggest problem with such ignorance is that it is just so expensive.

Now, even Darwin struggled to explain why we would evolve a response that lets others know that we have cheated or lied. Darwin would be trembling in his grave knowing how easily we have learned to cheat ourselves.

In search of proof how often and blatantly most of us, as investors, cheat ourselves, I set up Safal Niveshak's Investor Psychology Survey that was conducted over the past few days.

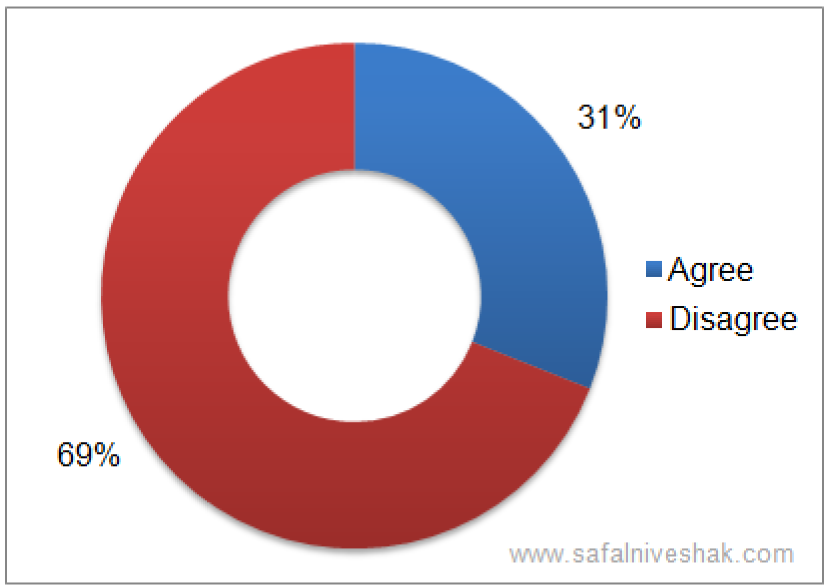
The results are not surprising, and prove that we, as investors, are really ignorant of ourselves…and thus often cheat ourselves!

Safal Niveshak's Investor Psychology Survey – Results

A total of 310 people participated in this survey, and here are the question-wise results…

1. When considering the track record of an investment, I put more weight on how it has performed recently versus how it has performed historically.

As per the results, a majority 69% of readers believe that they look at the long term history of an investment's performance and not how it performed in the recent past.



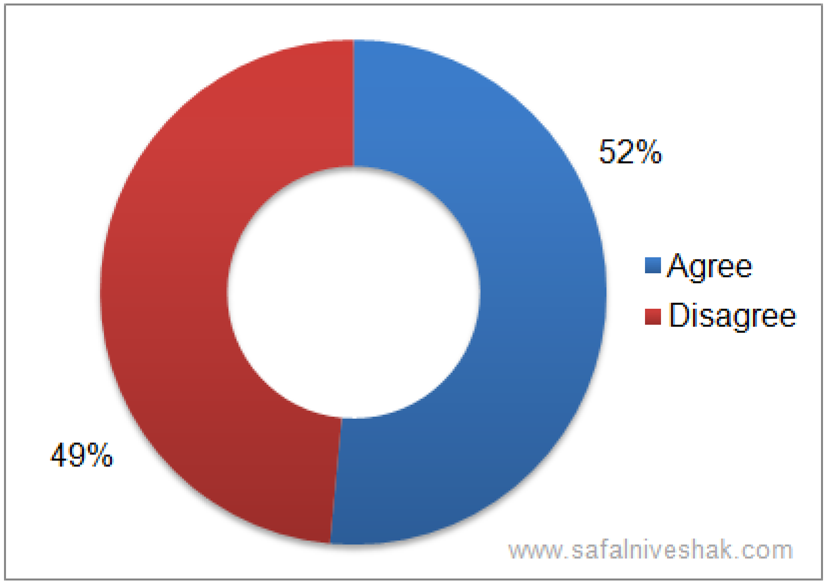
So, only 31% were honest that they fall for the **Recency Bias** – the more recent the information, the better we remember it – which is otherwise so widespread in investing!

You see, our short-term memory file cabinet, if there were such a thing, contains very little extra space. So when we receive a new piece of information, we have to remove an older piece to make room for the newer piece. That causes the recency bias.

But 69% of those who participated in this survey failed to acknowledge its presence during investment decision making!

2. When a stock from my portfolio is not doing well, I usually seek information that confirms I made the right decision about it.

52% of the participants agreed that that suffer from **Confirmation Bias** after making an investment, by seeking information or others' opinions that confirms they made the right decision. The remaining disagreed!



Warren Buffett says – *"What the human being is best at doing, is interpreting all new information so that their prior conclusions remain intact."*

Whether you go through life believing that "people are inherently good" or "people are inherently bad", you will find daily proof to support your case.

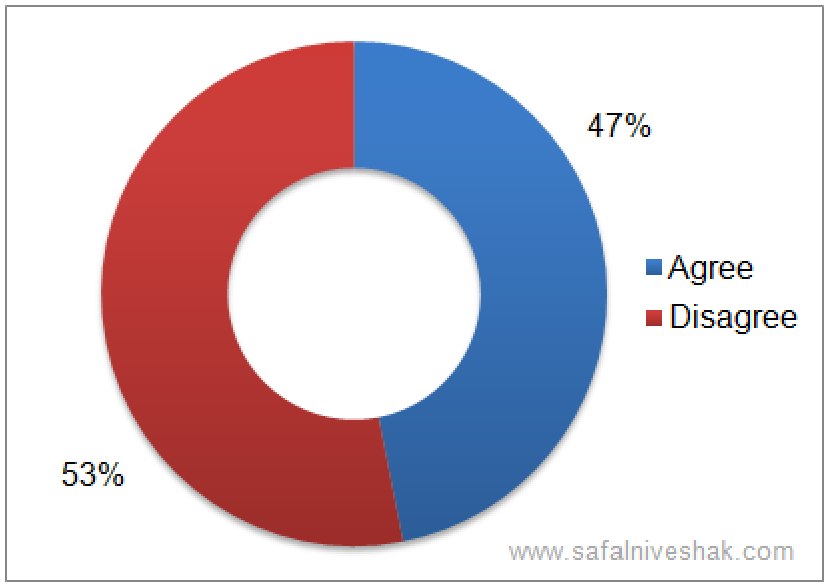
Rolf Dobelli, in his amazing book **The Art of Thinking Clearly**, writes…

> The Internet is particularly fertile ground for the confirmation bias. To stay informed, we browse news sites and blogs, forgetting that our favoured pages mirror our existing values, be they liberal, conservative or somewhere in between.
>
> Moreover, a lot of sites now tailor content to personal interests and browsing history, causing new and divergent opinions to vanish from the radar altogether. We inevitably land in communities of like-minded people, further reinforcing our convictions – and the *confirmation bias*.

Just look at your past investment decisions and you would know that you often try to seek confirmation for the decisions you have taken. Most investors do. But still a large number – 49% – don't agree they do!

3. When thinking about selling a stock, the price I paid is a big factor I consider before taking any action.

This was a shocker! A majority 53% think they don't consider the past stock price – like the stock's recent price or the price they had paid to buy it – while making their investment decisions today.



Now, that proves behavioural scientists like Daniel Kahneman, Robert Cialdini, and Dan Ariely are wasting their time studying and proving that **Anchoring Bias** is widespread!

You'd often hear yourself saying…

- "I will not sell this stock till I get my cost back."
- "This stock, at its 52-week low, looks very cheap."
- "This stock has not fallen to my last buying price, so I will not buy it till it falls there."
- "This stock has already doubled from my buying price, so I must sell before it falls."
- This stock has already fallen 90%. How much more can it fall?"

With respect to your last point, dear friend, a stock that falls from Rs 100 to Rs 5 first fell 90%, and then another 50%.

So, the truth is that anchors abound, and we all clutch to them. But most of us would still disagree that we fall for this trap!

4. I don't easily change my views about investments once they are made.

"It is easier to resist at the beginning than at the end", said Leonardo Da Vinci.

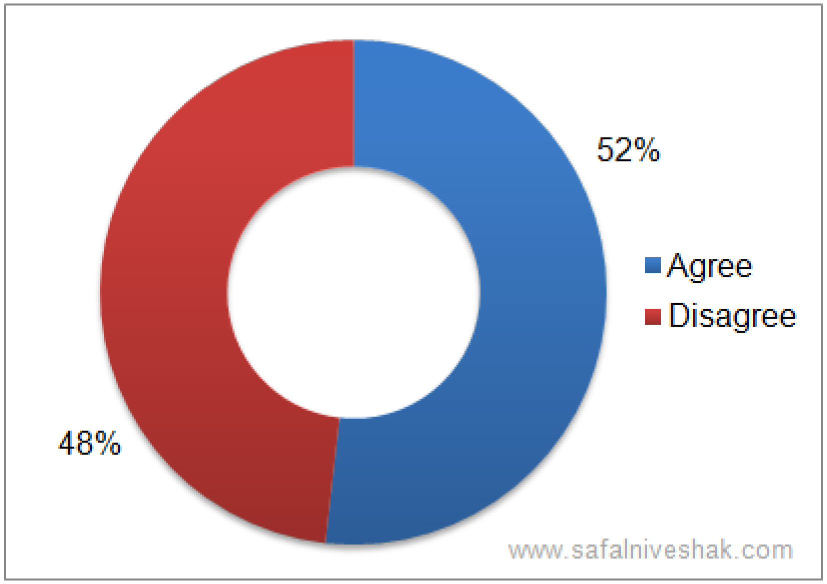
People at the racetrack are much more confident of their horse's chances of winning just after placing a bet, then than they are immediately before laying down that bet.

In the same way, I will find a stock more promising after I've bought it, than I did before I'd bought it.

Commitment and consistency bias lies deep within us, directing our actions with silent power. It is, quite simply, our nearly obsessive desire to be (and to appear) consistent with what we have already done.

So, once we make a choice or take a stand, we will all kind of pressures to behave consistently with that commitment. Those pressures will cause us to respond in ways that justify our earlier decision.

This is how most investors behave, but about 50% of them don't know this for a fact.

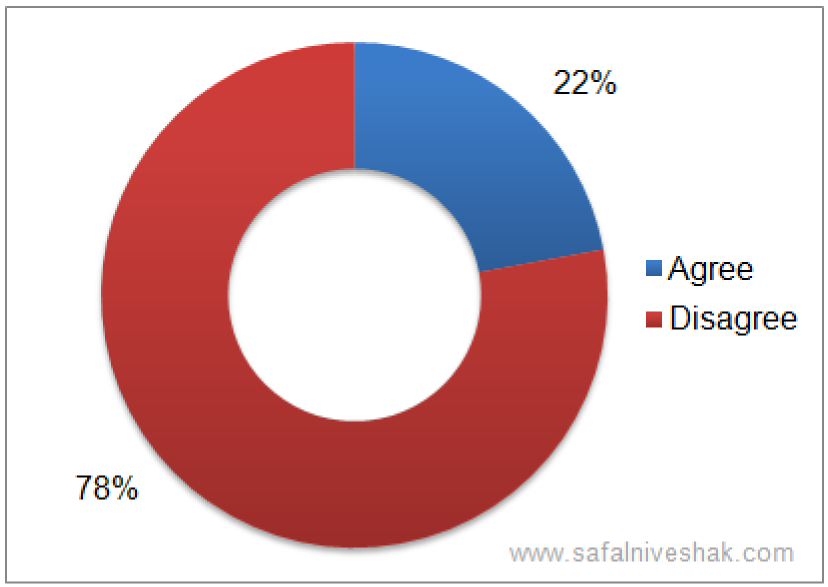


5. I am confident that my investing knowledge is above average and I can accurately predict how my investments will do.

"Man suffers much," said Russian-British philosopher Isaiah Berlin, "…because he seeks too much, is foolishly ambitious and grotesquely overestimates his capacities."

So, when things go right with us, we think "we made the right decision"…and when a thing does not work out fine, we believe it was "because of bad luck, bad economy, or bad market".

Thankfully, a large majority – 78% – disagreed that their investing knowledge is above average and they can accurately predict how their investments will do. So they don't suffer from **Over-Confidence Bias!**



Here again, a majority has proved how whimsical behavioural studies are that think people are generally over-confident, despite the fact that all men think all men are mortal but themselves.

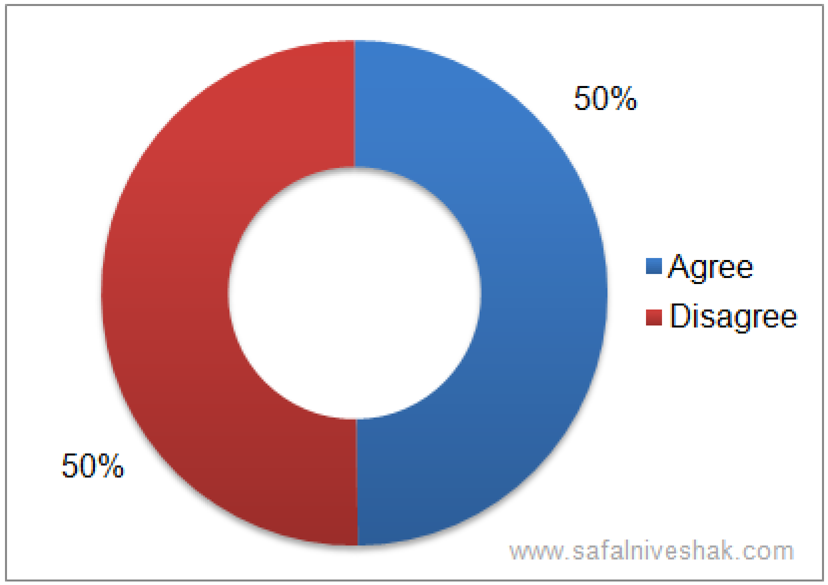
So while research has found that…

- 82% of people say they are in the top 30% of safe drivers
- 80% of students think they will finish in the top half of their class
- 68% of lawyers believe that their side will prevail
- Doctors consistently overestimate their ability to detect certain diseases
- 81% of new business owners think their business has at least a 70% chance of success, but only 39% think any business like theirs would be likely to succeed

…participants in the Safal Niveshak survey are not an over-confident lot. And that's again interesting! 😃

6. I often find that many of my best-performing stocks were bought based on my own decisions, while those that did not work out were based on tips from others.

Again, 50% investors who participated in the survey believe that they don't suffer from a **Self-serving Tendency.**



This is very close to the Overconfidence Bias, we discussed in the previous point above.

So when we fail, we blame external circumstances or bad luck. And when others are successful, we tend to credit their success to luck and blame their failures on foolishness.

Remember when you got an A+ in school, you thought you were solely responsible and the top grade reflected your intelligence, hard work, and skill. But when you scored a B or a C, the test or the teacher was clearly unfair.

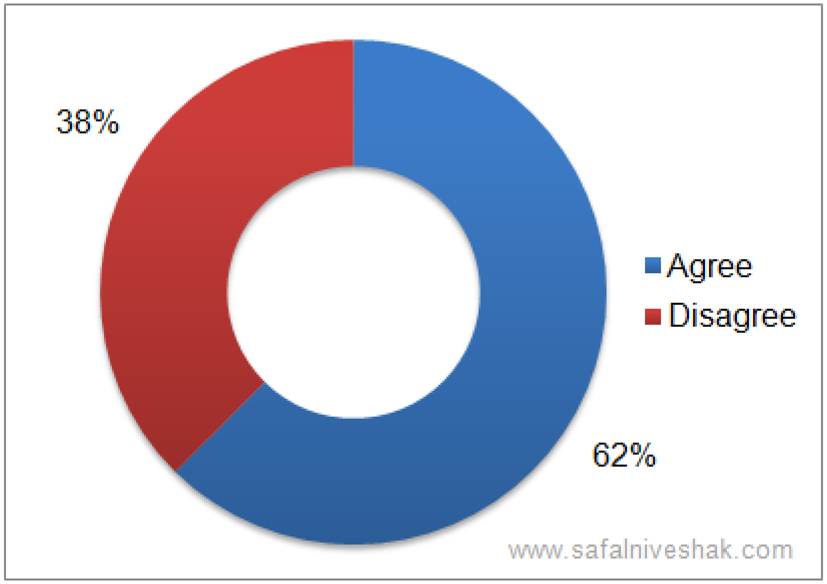
When our investments turn into losers, we had bad luck or we blame the stock markets or Safal Niveshak for "recommending" bad stocks. When they turn into winners, we are geniuses.

This way we draw the wrong conclusions and don't learn from our mistakes. We also underestimate luck and randomness in outcomes.

But 50% investors, as per the survey, don't believe they have this tendency. 😃

7. If an investment makes sense to me, I often take action on it right away.

A clear majority – 62% – believe they easily jump to conclusions, and thus suffer from **First Conclusion Bias**, which is an honest answer, as proven by behavioural scientists.



Our minds jump to conclusions, and we tend to solve problems by using the first solution that comes to mind.

Charlie Munger often says that "to a man with a hammer, everything looks like a nail."

Prof. Sanjay Bakshi gave a real life example in his **interview with Safal Niveshak**…

Let me give you an example of this from my own experience, as to why first conclusions are often wrong.

Let's go back to the year 2003. This was the time when the steel industry was down in the dumps, and it was about to take off for a very big bull run. At that time, some of my value investor friends and I came to the conclusion that steel prices are going to go up. This was a time when most steel companies in the world were losing money. In fact, there were just a handful of companies that were making any money.

The steel cycle had been down for a very long time. We felt that here was a tipping point coming and things would get better, and steel prices will go up because steel capacity is getting tight and world economy, and in particular, Chinese economy, is growing. Therefore, we thought there was going to be a shortage of steel, and it would take a long time for the shortage to go away because steel is a long gestation period industry.

We concluded that steel companies would benefit because of the huge rise in steel prices, which was a great insight. So far so good! But apart from concluding that rising steel prices must be good news for steel stocks, we also concluded that the same would be horrible news for auto stocks. This kept us away from auto stocks based on pure automatic first conclusion that high steel prices were bad news for auto stocks. That first conclusion turned out to be wrong.

Think about why it went wrong. The value of an auto stock (or any stock) is based on present value of its future cash flows. And rising steel prices may or may not be bad news so far as those cash flows are concerned. A rising input price may be passed on to customer without suffering any volume decline. Or the rise in volumes caused the industry growth, may more than offset the shrinkage in margins because of a rise in input prices, which the company is unable or unwilling to pass on to customers.

So the key factor to think about is not impact on margins but impact on cash flows. But the mind doesn't always do this automatically. It jumps! It jumps to first conclusions, which are often wrong.

So you really have to train yourself out of first conclusion bias. You have to avoid seeking easily available answers to questions that begin with "why".

The first conclusion bias really hurts investors when it comes to value traps. I say this from my personal experience in buying a few of such traps in the past.

It is useful to think about this in the following manner. There is a universe of stocks out there. A sample of such stocks is value stocks. A very large proportion of these value stocks are value traps. They are cheap for a very good reason. And they're going to remain cheap.

People make this misconception of first conclusion bias that "because it's cheap, I must own it. And if I own it, only good things will happen to me."

Well, often it doesn't!

So I feel happy to see a majority agree that they fall for the first conclusion bias. Why happy? It is because the first step of saving yourself from a bias is to agree that it exists in the first place.

8. I sometimes get attached to my stocks, which causes me not to take action on them.

"She likes me…she likes me not…she likes me…she likes me not." You must have heard these statements at several instances in the past.

"Do you really like me?" asks my wife often. "Yes I do!" I tell her even more often. 😃

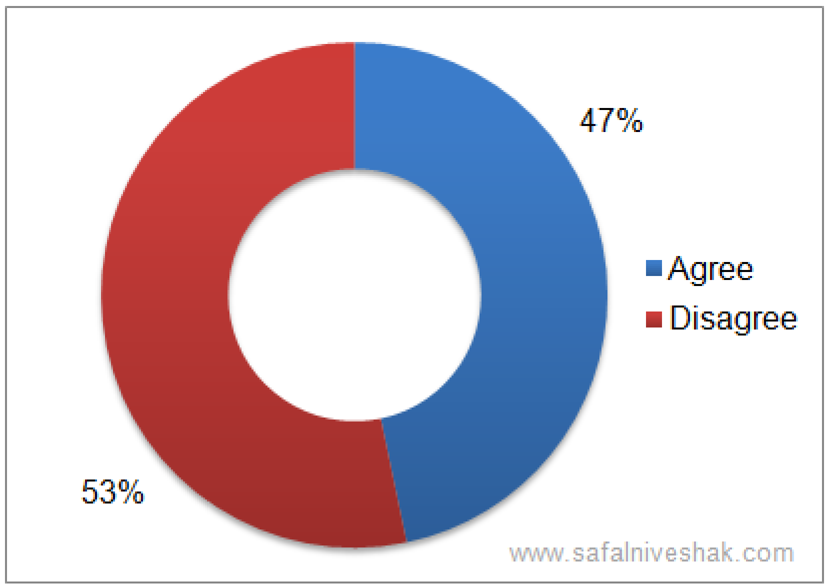
The **Liking Tendency** is deeply ingrained in us. So, while it serves us well when it concerns people close to us, we often fall prey to its negative effects when it concerns others.

So you may end up buying something you wouldn't have, just because the salesgirl was charming.

Why do you think advertising is full of attractive people? Why do you think a product like Coca Cola – which damages your health – always shows happy people, and happy kids? Why do most financial experts and investment bankers dress up so well while meeting clients?

It is because marketers and experts understand how people 'like' outwardly attractive people and behaviour.

In investing, we like stocks we own more than if we hadn't owned them. Despite the fact that a stock does not know you own it, you will fall in love with it and not part with it despite knowing that it was an ugly duckling.



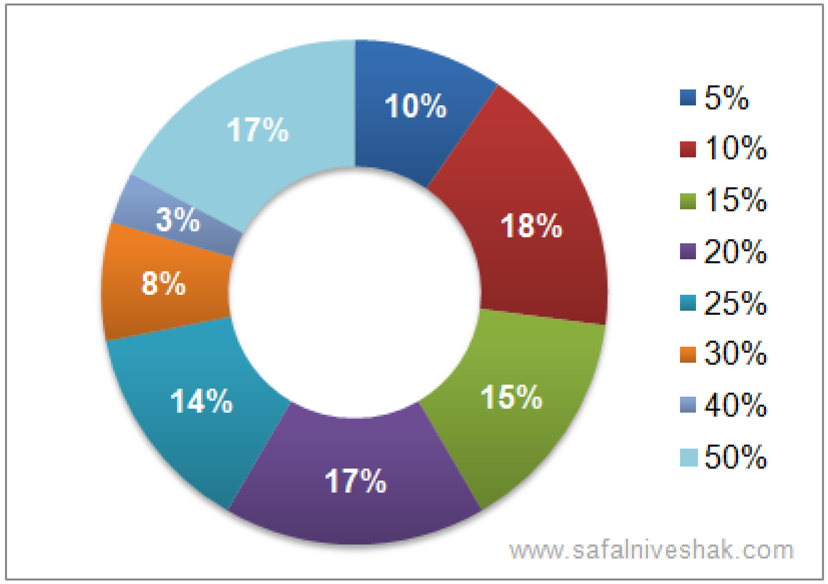
Most investors behave like this. So it appears strange that a majority of those who participated in the survey – 53% – disagreed that they get attached to their stocks.

Oh yes, it should not appear strange because, you see, we are ignorant of ourselves…and continue to believe that we don't have the liking tendency!

9. Suppose that you could replace your current stock portfolio by a new one. The new portfolio has a 50% chance to rise by 50% over the next 3 years. However, the new portfolio also has a 50% chance to reduce by X% over the next 3 years. What is the maximum X% reduction in your new portfolio you are willing to accept?

The lower the number you chose, the more you think the pain of a decline outweighs the joy of an increase. For instance, people who are willing to accept a maximum 25% reduction in their new portfolio are effectively saying that the potential pain is twice as important as the potential joy.

As far as this survey is concerned, the largest number of participants chose the 10% loss number, which shows that the potential pain of losing money is five times more than the potential joy of earning positive returns.



This is **Loss Aversion Bias** at work, and it is indeed at work as the survey results show.

In fact, 72% of those who participated have chosen a potential loss of less than 25%, which simply shows how a majority of us just hate the sight of losing money – and that is proof why we hold on to our losers (to get our money back) and sell our winners (so that we don't lose the gains).

Interestingly, the most honest answer in this survey of how investors really behave came for this last question, simply because this question does not give you "obvious" and "correct-sounding" choices.

The Final Verdict

Here is the final results of Safal Niveshak's Investor Psychology Survey…

Do I suffer from…	Yes	No	Result	Explanation
Recency Bias	31%	69%	Fail	You suffer, but you denied
Confirmation Bias	52%	48%	Fail	You suffer, but you almost denied
Anchoring Bias	47%	53%	Fail	You suffer, but you denied
Commitment Bias	52%	48%	Fail	You suffer, but you almost denied
Over-Confidence Bias	22%	78%	Fail	You suffer, but you denied
Self-Serving Bias	50%	50%	Fail	You suffer, but you denied
First Conclusion Bias	62%	38%	Pass	You accepted
Liking Tendency	47%	53%	Fail	You suffer, but you denied
Loss Aversion Bias			Pass	You accepted
Final Verdict			**FAIL**	

Investor Beware…of Yourself

Rolf Dobelli writes in **The Art of Thinking Clearly**…

The Pope asked Michelangelo: 'Tell me the secret of your genius. How have you created the statue of David, the masterpiece of all masterpieces?' Michelangelo's answer: 'It's simple. I removed everything that is not David.'

Let's be honest. We don't know for sure what makes us successful. We can't pinpoint exactly what makes us happy. But we know with certainty what destroys success or happiness. This realisation, as simple as it is, is fundamental: Negative knowledge (what not to do) is much more potent than positive knowledge (what to do).

Thinking more clearly and acting more shrewdly means adopting Michelangelo's method: don't focus on David. Instead, focus on everything that is
not David and chisel it away. In our case: eliminate all errors and better thinking will follow.

This is exactly like what Charlie Munger says so often – *"If you want to avoid irrationality, it helps to understand the quirks in your own mental wiring (everything that is not David) and then you can take appropriate precautions."*

In any investor's learning process, there are great dangers in covering behaviour at the end simply because how we behave matters the most in how we perform as investors.

Thus, while designing my **Mastermind Value Investing Course**, I have included the part on "human psychology and investing" as the very second module.

The Safal Niveshak Mastermind

Value Investing Course: Modules & Content

Module 1 Start	Module 2 Human Element	Module 3 Generating Ideas	Module 4 Building the Case	Module 5 Calculating Valuations	Module 6 Making Decisions	Module 7 End
Investing Vs. Speculation	How to Create a Value Mindset	Building Circle of Competence	Competitive Moats	Understanding Value	Power of Checklists	Creating a Philosophy
Being a Value Investor	Psychology of Investing – 10 Ways Our Brains Fool Us	Analysis of Three Key Sectors	Financial Stat. Analysis	Key Valuation Methods	Value of Process and Discipline	Immutable Laws of Investing
Is Value Investing Really Profitable?	Building a Latticework of Mental Models	Gathering Relevant Information	Ratio Analysis	Putting DCF to Practice	Dealing with Risk and Uncertainty	Understanding the Role of Luck
Benjamin Graham's Tenets		Screening for Quality	Identifying Moats through Numbers	Margin of Safety	Fat Pitch Investing	Deadly Sins of Investing
From Graham to Buffett			Financial Shenanigans	Paying Up for Quality	Contrarian Investing	Can You Really Beat the Market?
The Most Important Things			Assessing the Management	Identifying Value Traps	Constructing a Portfolio	Go, Compound
				The Dividend Dilemma	Concentration Vs Diversification	

The deeper I research for the purpose of writing out my lessons, the more I believe that without the right investment behaviour, you will never succeed as an investor.

Many of the reasons for bad behaviour are rooted in psychological tendencies and biases that often influence us subconsciously.

The more emotional, confused, uncertain, insecure, excited, distracted, tired or stressed we are, the easier we make mistakes.

A Greek philosopher said this in the 2nd Century – *"Why oh why are human beings so hard to teach, but so easy to deceive."*

Eighteen hundred years later, that saying remains true!

Want to Learn the Psychology of Investing?

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Click here to subscribe before admissions close on 25th August 2013.

Thank you again for being there!

About Safal Niveshak

Safal Niveshak is a movement to help you, the small investor, become intelligent, independent, and successful in your stock market investing decisions.

My name is Vishal Khandelwal, and I am the Founder and Chief Tribesman of *Safal Niveshak.*

Before starting work on the idea of *Safal Niveshak*, I was working as a stock market analyst for eight years.

During this period, I felt the pain of seeing small investors (like you) lose large amount of their hard earned money, for reasons ranging from:

- Scams…where companies simply vanished, to
- Speculation…to earn fast money, to

- Bad decisions…mostly backed by insensible and short-term advice from self-centered brokers and self-proclaimed stock market experts.

While the probability of a stock market analyst to work on a social cause is miniscule, here I am driving this movement called *Safal Niveshak* – to help you become intelligent, independent, and successful in your stock market investing decisions. Through my experience in the stock markets, I have come to believe that:

- You alone are the most capable person alive to manage your money.
- Investing in the stock markets is not a rocket science. You just need to form the right habits, and behave yourself.
- You can create a lot of wealth for yourself doing it.

You can write to me at vishal@safalniveshak.com to know more about this initiative and how you can benefit from it and/or support it.

With respect,
Vishal Khandelwal (*Chief Tribesman, Safal Niveshak)*