“What kind of investor are YOU?”

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Whatever you precisely want to achieve with the money you invest, my guess is that you aren't someone who is happy with mediocrity.

This applies to your portfolio or your SIPPs or your ISAs.

You might express this is in one of two ways depending on whether you are a glass half full or half empty kind of person:

"My investing is OK, but I have a sense that I can do better"

OR

"My investing is not good enough, frequently frustrating, and I know I can do better"

How you express it also says something about you, at least in the context of your investing.

For example, you might normally be a very confident and decisive person, but, as some have fed back to me, when it comes to investing you feel out of your comfort zone.

Or you might be very confident dealing with your own money, but are ambitious to do better.

> My focus is on helping you boost your investment returns primarily through funds. But nearly all of what is covered in this document is equally applicable if you are also buying individual shares; and the attributes of a successful investor are the same whether you are investing in funds or individual shares or options and futures or spread betting.

Either way, the results of most people's investing efforts are simply not good enough.

This is results from 4 fundamental problems:

1. most funds are not good enough, 92% of funds are mediocre at best
2. emotionally, we are VERY badly designed to be outstanding investors
3. nearly all of us lack the most basic schooling in financial matters, and investing in particular.
4. this lack of financial education has allowed a volume of myths to flourish, and quite a few bad habits – many of which I covered last week

I will show you how to deal with each of these in other notes.

Right now, I want you to consider your investment personality, which is key to solving problem 2 above.

Your (our!) Inherent Inability To Invest Successfully

Humanity, that's all of us, has an inherent inability to succeed at investing. You need to understand this if you are to transform your investing.

When most grown up humans refer to "behavioural problems" they normally have in mind their dogs or children. Yet most of those same humans have no sense that the biggest barrier to improving their investment prowess is not superior knowledge or skills or volume of information – it is overcoming inherent behavioural problems.

In 1769 Ben Franklin said that

"There are three things extremely hard:
Steel, a diamond, and to know one's self"

Yes, trying to know "one's self" can feel a bit awkward.

Few of us are very good at thinking about ourselves, and going back over our mistakes. It is like inviting someone to break one of our arms!

Some of you will already be twitching in your seats, wondering if you should put the kettle on or find something on TV – it really depends on how determined you are, about how ambitious you are, about transforming your investment success.

Why should I listen to this guy at all?

I have been doing this a long time – but so have many others.

What makes myself and my team stand out is the long-term commitment to research and innovate, our objective being purely and simply to provide the best investment solutions for clients

That is my passion and life's work, and drives myself and colleagues to discover outstanding investment solutions

That is why the national press and TV and radio have been asking for my views for around 20 years

And why we have volumes of testimonials from happy clients.

Last but not least, unlike many who have something to say about investing, I have been doing this for a long time in the REAL world – there is no theory here – these are not the experiences and ideas and research of other people – this is the experience of myself and the team for more or less 30 years – and it is highly practical.

That is why every week the national press asks for the input of myself and my colleagues on a range of investment matters

Brain Basics – Old Brain vs New Brain

I'm starting with the basics, and apologies to the psychiatrists and brain surgeons out there, think of the brain in 2 parts:

- the old brain
- the new, more recently developed, brain

Our old brain is extraordinary, a marvellous tool when we lived in dangerous environments full of risk and uncertainty – tens of thousands of years ago the old brain enabled our ancestors to make decisions RAPIDLY whenever there might be a hint of a threat, or some level of uncertainty.

In contrast, the new brain (at least new in evolutionary terms) is more rational, thoughtful, BUT SLOWER.

Our problem is that when we invest, **the wrong part of the brain jumps into action.**

Investing is an inherently uncertain endeavour of modern man, but faced with uncertainty it is still our old brain which jumps into action - a "quick and dirty" system takes shortcuts with very limited information.

FundExpert was created because we believe that very few people get close to their potential when investing. Our objective is simple – to unlock your potential. This does not mean taking more risks, on the contrary. It is primarily about making better choices.

From a survival point of view this would have been vital on the savannah thousands of years – but it EXTREMELY unhelpful in a modern context when investing.

Knowing that our brain works in this unhelpful way has been understood for a long time.

In 1912, in "Psychology Of The Stock Market", it was said:

> *"Wonderful as is the development of the human brain, it originated as an enlarged ganglion, and its first response is still that of the ganglion"*

Apparently, ganglion cells aid in the release of hormones, playing an important role in the human body's instinct to "fight or flight" – and it is this primeval unconscious tendency to fight or flight which lies at the heart of lack of investing success.

Some people have a FIGHT tendency and some have a FLIGHT tendency, in both cases driven by the fast-moving old brain.

Our Optimism Bias

For example, most of us, at least in our daily lives, have a bias to optimism, which is again appropriate to yester-millennium but not as a constant investment strategy:

Imagine you are roaming Europe 50,000 years ago, hunting for food.
Driven by survival instinct, you needed to be very optimistic to conclude:
"I can successfully hunt and kill this woolly mammoth...
even though it is faster than me and 50 times bigger"
This is the "fight to survive" instinct, and it requires a deep streak of optimism.

Many investors take this over-confidence or over optimism into the investment arena, which makes them VERY exposed when markets are dangerously over-valued.

Overconfidence is another type of optimism. This has been surveyed and proven over and over again. Most of us (investors or not) over-estimate our predictive abilities. As a result, we under-estimate risks and over-estimate expected returns.

Illusion of control

This a particularly worrying tendency in recent years. With the internet many investors now have a more active involvement, which inflates confidence, and creates the illusion that they can control the outcome to an extent which is simply not warranted.

Characteristics are:

- buy and selling excessively
- inadequately diversifying

- too many failed or failing funds
- poor returns

Joined together these characteristics lead to both more risk and lower growth, as well as regular frustration and much wasted time.

Are you an over confident investor? Consider the following:

Are you a trend chaser? (with little attention to valuation)

Do you buy into the latest fad?

Do you think you are smarter than most other investors?

Do you always assume you are right? Never allowing for the possibility that your investment will fail?

Take Isaac Newton. Big brain. But he had to lose his shirt before he realized that over-optimism is just another form of insanity.

If he had just stuck to the facts, and made a rational judgment, he would never have re-entered the stock market just before the South Sea Bubble burst in 1720. But in the worlds of Kindleberger, who wrote a superb history of bubbles and crashes,

"there is nothing so disturbing to one's well-being and judgement as to see a friend get rich".

The solution? An investment plan

But most investors do not have one.

Why not?

For many investors this is, again, about their over-confidence, a curse for investors.

They don't feel they have a need – they don't believe they will panic or get emotional – they do believe they will make great investment choices.

But the evidence suggests otherwise, as I cover in detail in other notes, and regularly in our blogs.

Optimism and confidence remain a great life strategy in today's world - but a deadly combination for investors. Remember, over confidence and over optimism lead to:

- Too much risk
- Too little growth

Your tendency to fight or flight

Both flight AND fight are two evolutionary instincts with the same objective in an environment full of risks and uncertainty:

- improving our chances of survival

They are two completely different ways of achieving the same survival objective.

In modern times some people are more flight inclined, some tending more to fight.

These feed into your investment personality.

If more flight inclined your portfolio will likely tend to be cautious.

If more fight inclined your portfolio or investments will tend to have a more aggressive slant, based on an underlying confidence.

I just looked at the issue of optimism and confidence. Now I will consider a tendency to caution and flight.

Characteristics Of The More Cautious Investor

These are the investment characteristics of the more cautious investors, with more of a tendency to flight than fight:

- You don't like change, as change creates uncertainty
- Your brain will try and avoid uncertainty and mental stress…
- …so you go through mental contortions to convince yourself that the status quo is the best option
- New information is often complex, so you tend to avoid the mental stress and effort of processing it…
- …you would rather a simple, but wrong, solution

Loss aversion. Investors hate losses much more than they enjoy gains or success. So, if one investment is losing money, and another is making money, we sell the winner! (There is lots of academic and real-world evidence on this point)

This is madness.

But we convince ourselves that there isn't really a loss unless we sell, and that the investment will work out eventually.

This is one of the major reasons why so many private investors and fund managers perform poorly. It often results in a lop-sided portfolio of losers.

This fear of losing money might arise for a range of reasons e.g. a poor prior experience, or insufficient knowledge triggering lack of confidence.

Status quo bias. People and investors are generally more comfortable keeping things as they are rather than with change.

The solution is making yourself aware of the value of alternatives, and being better informed about the facts that matter. I hope the fact that you are reading this means that you are already on that journey.

Conservatism. This can manifest itself in different ways and for different reasons.

For instance, a tendency to cling on to initial beliefs, and being slow to act on new information.

The issue here isn't being fundamentally cautious, it is being slow.

For example, you believe there is a bear (falling) market, and that you shouldn't invest wholeheartedly. You continue to hold this belief long after it is obviously wrong, and the markets are considerably higher, and your profit potential is lost.

Remember that changing a prior belief is mentally stressful, and we understandably want to avoid what is stressful – we will go through all sorts of mental contortions to sidestep admitting that we might be wrong.

Confirmation bias. This is a tendency to seek out what confirms our belief, and ignore what might contradict us.

A characteristic is holding on to poor funds or investments for far too long.

Which of these investors is most like you?

So far you have seen two broad types of investors:

- Confident investors
- Cautious investors (less confident)

Now let me put a bit the meat on the bones, with 4 types of investor.

Which one of these investor types seems most like you?

Be honest with yourself! Don't try and choose the one you would like to be – as you will see, none of these profiles is without some additional characteristics which you need to tackle

INVESTOR 1

- Think carefully
- Cautious
- Want to preserve your wealth
- Often worry about short term moves in valuations
- Not always good at changing funds

INVESTOR 2

- Have your own investment ideas
- Interested in investment
- Gather lots of facts
- Avidly read the press
- Change funds reasonably regularly

INVESTOR 3

- Possibly a busy professional person
- Not overly interested in investment
- Listen to investment ideas of friends
- Tend to hold large cash balances
- Have been known not to open investment statements

INVESTOR 4

- Noted success in own business life
- Interested in investment
- Typically confident
- Change funds very regularly
- Act decisively

INVESTOR 1 - THE CAUTIOUS MINDED INVESTOR

- Think carefully
- Cautious
- Want to preserve your wealth
- Often worry about short term moves in valuations
- Not always good at changing funds

Problems

- Quite emotional
- Inclined to be too low risk.
- May sell winners too early
- Afraid to make decisions in case they make the wrong one…
- …and will hold on to losers as realising a loss is too painful
- May obsess over short term performance
- Can be easily knocked off balance by events such as 2008…
- …and as a result panic into selling

Possible categories

- Someone who is naturally cautious
- Someone who is now cautious due to their age
- Someone who was knocked off balance by 2008 or another bad experience
- Someone who is tactically cautious

Solutions

- Understand there is nothing wrong with being cautious
- Understand long term benefits of investing...
- But not kid ourselves over risks
- Understand market valuation issues
- Understand time to buy is maximum pessimism
- Understand that it will feel horrible when markets fall sharply...
- ...but this is your opportunity

INVESTOR 2 - THE INDEPENDENT-MINDED

- Have your own investment ideas
- Interested in investment
- Analytical, mostly
- Change funds reasonably regularly
- Avidly read the press

Problems

- Contrarian mindset might mean doesn't believe in long term planning
- May act too quickly and not think through sufficiently e.g. confusing reading a newspaper tip with doing original research
- In pursuit of profits they may leave stones unturned
- Yet in other cases might be too analytical and get bogged down
- May lack diversification...
- ...and over commit to big bubbly trends
- Invest with funds that do most advertising, instead of looking at cold hard facts
- Perhaps surprised to learn many of the best funds are not advertised
- Tend to buy and sell too often

Solutions

- Understand long term benefits of investing, through knowing facts and benefits of being diversified
- Understand market valuation issues as big trends emerge
- Get into habit of challenging self...
- ...and reading other points of view
- Document with facts why you bought...
- ...and when/why you will sell
- Understand that it will feel horrible when markets fall sharply...
- ...but if you are patient this is your opportunity
- Understand that sometimes doing nothing is the wise move
- Know that a plan is more efficient and less stressful

INVESTOR 3 PREOCCUPIED INVESTOR

- Possibly a busy professional person
- Listen to investment ideas of friends
- Not overly interested in investment
- Tend to hold large cash balances
- Have been known not to open investment statements (post or internet)

Problems

- Tend not to follow long term plans
- Tend to invest towards the end of trends
- Keep very large cash balances...
- Doing superficial research, taking advice from friends, not opening statements
- Think taking risks is a good idea
- Recent events are given disproportionate weight
- They tend to be disconnected from investment processes and trends...
- ...then when the trend is obvious they jump on board, very late in the day

Solutions

- Understand long term benefits of investing, through knowing facts and benefits of being diversified
- Understand how difficult it is to predict the best asset class from one year to the next
- Learn to refrain from over estimating their own risk tolerance
- Avoid hot ideas from friends, or "marketing" advisers
- Education on diversification
- Always document evidence as to why you buy something, challenge yourself
- Know that a plan is more efficient and less stressful...
- …and that some plans can be quite simple

INVESTOR 4 - THE CONFIDENT INVESTOR

- Noted success in own business life
- Interested in investment
- Typically confident
- Change funds very regularly
- Act decisively

Problems

- Has the greatest potential...
- …but also is most at risk
- Often in a race to win, and to win big
- Make frequent changes, but not within a structured plan
- Believe the best way to manage a portfolio is to constantly change it
- Over confident in their investment abilities
- Don't believe in basic investment principles such as diversification/asset allocation
- Concentrating their bets in too few areas
- Believe they can control outcomes
- Don't take account of investment outcomes often being random, with unknown risks
- Often extravagant rather than prudent
- Can get agitated and nervous during stressful times, and then make poor investment decisions

Solutions

- Need to recognise that investing is a probabilistic activity...
- ...it is all about moving the odds in your favour against the background of great complexity
- Need to understand they cannot outsmart the markets on a regular basis
- Need to understand they CANNOT control the outcomes as the reality is too much uncertainty and a very complex web of factors interacting
- Need to understand that a simple plan is much more efficient use of their time...
- ...and can generate more consistent results

CONCLUSION

You need to acknowledge which of these problems apply to you.

Then you must build these into your written investment plan.

YOU MUST HAVE SUCH A PLAN TO UNLOCK YOUR INVESTING POTENTIAL.

Helping you build such a plan is a key part of Gold Membership with FundExpert.

In your plan you acknowledge what type of investor you are, with certain unhelpful tendencies, and build solutions to these into your plan.

This not so much to save you from yourself, but to save you from your wayward old brain!

I'm reminded of Odysseus when he realised that he might be fatally distracted by the songs of the sirens.

He ordered his men to tie him to his mast, to stop him doing something daft.

Your plan is a bit like the restraints on Odysseus – knowing your weaknesses and planning in good time to circumvent them.

This is a taster of how becoming a Gold Member can transform your investing success.

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