Brent Sheather's RESEARCH

Private Asset Management Ltd

December 2024

Brent Sheather is a Financial Advice Provider and a personal finance and investments writer.

INVESTORS JUST WANNA HAVE FUN – PART 2

In the last column we explored the idea that, for some people, investing offers more than just financial benefits: many individuals, and certainly most of us who are involved in the industry, regard investing as an interesting pastime, possibly even up there with stamp collecting, gardening and bowls. Despite these comparisons the investment world's attractions aren't just limited to older people – young people are into it too as evidenced by the popularity of investment platforms like Sharesies locally and Robinhood in the USA. Despite all the research on behavioural finance, I wasn't able to find much in the way of academic research on this topic, which is surprising, however a lot of work has been done on "the gamification of finance". This research focuses more on making comparisons with gambling and the tendency of platforms to facilitate short term trading. But a survey of more than 2,000 people in Britain also suggests that there is more to investing than just the potential for financial returns. The conclusions of the survey, by British firm Wealthify, back in 2018, were as follows:

"74% of the investors taking part in our survey said they get a 'buzz' when they see a return on their hard-earned money, equating the feeling most closely to bagging a bargain on the high street, going on holiday, or being promoted at work. One in six (14%) described the buzz they got as 'massive'. The excitement of a good return outshone the achievement of losing weight for most investors, and one in ten even said the buzz was comparable to having sex, although men and women failed to agree on this point, with 15% of men and only 4% of women likening the two.

Seeing a profit appears to produce an adrenaline rush for most Brits, but what about more lasting psychological effects? In our survey, UK investors also cited getting real emotional benefits, reporting feeling in control (36%), satisfied (35%), secure (31%) and confident (20%) about their finances as a result of their investing habits. In contrast, only 6% of those surveyed reported being scared or confused, and just 8% said it gave them cause for worry."

Given the above perhaps we can summarise investor objectives as follows:

- Firstly to generate competitive returns, close to or above that of the index, acknowledging that there will be volatility quarter to quarter. Investors who manage to approximate index returns over the medium to long term can, with low fees, low turnover and absent the standard conflicts of interest, be reasonably confident that they will do OK and be able to speak loudly and confidently about their returns at barbeques and cocktail parties. They will be popular with men and women even if they have poor dress sense and bad haircuts.
- Retail investors' second objective should be not to lose and they can do this by having a core exposure to low cost, broadly diversified passive and active funds, resisting the temptation to bet the house on "good ideas", trimming overweight positions and guarding against falling in love with stocks that have done well.

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This strategy is designed to manage tracking error, is an insurance policy against bad decisions, and it acknowledges the fact that it's hard to outperform.

- Last objective, and this is relevant to some investors and not others, is to have fun. It's fun to buy a stock when it is down and see it do well. It's fun to note that, because ESG investors won't buy defence stocks, that they are cheap, add some to your portfolio and watch them outperform. The key however is to ensure that you aren't having so much fun that your portfolio materially deviates from best practice, you are taking too much risk and it performs poorly. This is not fun and means that, at barbeques and cocktail parties, you will need to deflect the conversation away from investment towards stuff like what the grandchildren are doing, your medical issues and, worst-case scenario, sport.

As mentioned earlier having fun poses the risk that your portfolio becomes unbalanced, higher risk and performs badly. Many financial intermediaries encourage clients to have fun because this means more engagement, more turnover and higher fees. Some clients are more receptive to speculating than others with reasons including a need to feel special, to be a "winner" and owning an individual stock feels more personal than a broad based fund. Given the temptation to run with a concentrated portfolio a critical tool for measuring and managing "fun" is a portfolio management system that permits clients to compare performance with relevant benchmarks. Keeping a close eye on performance means that we can determine whether "having fun" is adding value or not. Performance benchmarking potentially provides both clients and advisors immediate feedback as to whether they are achieving the first and most important objective and whether your advisor is providing value for money. So comparing performance with benchmarks can, if done properly, provide important feedback. However benchmark abuse is embedded in the investment industry and the results of "fun" can be illusory: I recently saw a quarterly review from a major advisory group where the advisor waxed lyrical about the portfolio's return over the year but a closer investigation revealed that a representative benchmark had returned twice the level of portfolio's return. As my recent series on the behavioural aspects of ethical investment demonstrated, based on a paper by Hersh Shefrin, the extent and nature of the "fun" can be manipulated by using fake benchmarks and worshiping false gods.

Brent Sheather is a Financial Advice Provider. A disclosure statement is available upon request. Brent Sheather may have an interest in the companies discussed.