

As We See It

There are no certainties in this investment world, and where there are no certainties, you should begin by understanding yourself.

– James L. Fraser

In *Investment Psychology Explained* (1993) author Martin J. Pring reviews the psychological aspects of the financial markets and its participants. One of the more interesting segments of the book is the section discussing personal psychology and the need to understand oneself. When referring to the difficulty of beating the market, the author states, ". . . it is the job of beating ourselves that proves to be overwhelming. In this sense 'beating ourselves' means mastering our emotions and attempting to think independently, as well as not being swayed by those around us."

The author identifies several emotional tendencies investors must master and control if they are to be successful in the market. His first observation identifies a tendency for unsuccessful investors to futilely seek a system which will enable them to get rich quickly. In the words of the author, "There is no Holy Grail principally because market prices are determined by the attitude of investors and speculators to the changing economic and financial background. These attitudes tend to be consistent but occasionally are irrational, thereby defying even the most logical of analyses from time to time." Successful investors have learned that prosperity comes from ". . . hard work, common sense, patience, and discipline."

Next, Mr. Pring notes that investors who have learned to control their emotions and think objectively prosper from this trait. According to the author ". . . price fluctuations will be determined by the hopes, fears, and expectations of the crowd as they attempt to downplay future events and their biases toward them." Successful investors largely ignore the actions of the crowd to form independent opinions while striving to overcome their own prejudices.

A third characteristic of successful investors is the ability to think independently. The author points out that external information which originates from colleagues, the media, and events going on around us, for the most part, ". . . have an unhealthy effect on our emotions, distracting us from clear and independent thinking." Most successful investors think for themselves and have the courage of their convictions.

Another aspect of market psychology which must be conquered is captured in the sage advice "pride goes before a loss." Basically, the pride one has for their own opinion often generates a stubbornness to change. In turn, investors often express this stubbornness through an inability to admit a mistake. Pring observes, "After a long winning streak, almost every investor and trader falls into the trap of thinking he is infallible. Unfortunately, the market has a way of exposing this weakness, and quite a long run of success is wiped out in a fraction of the time that it took to accumulate the profit. Overconfidence and enthusiasm breed carelessness leading to poor market judgment and an inappropriate amount of leverage, since it is a human tendency to take on more risk after a run of success." Recently, the misuse of derivatives has exposed this human frailty. These incidents illustrate how important it is that investors develop the ability to distinguish between the courage of their convictions and a mere stubbornness to change their mind.

Other virtues exhibited by accomplished investors are patience and the emotional fortitude to stay the course. Many investors try to call every twist and turn in the market and in so doing lose perspective. It is far wiser to develop a sound investment plan, stay the course as long as the long-term fundamentals do not change, and have the patience to see the plan through to fruition.

Recognizing there is no true get-rich-quick system, learning to be objective, to think independently, to admit a mistake, to be patient, and to stay the course are virtues which increase the likelihood of investment success. These personality traits are not inherent in most people. They must be learned and the learning process can be long and difficult, but the journey is a worthwhile one. Investing, like many aspects of our lives, can be more rewarding if we are able to master our emotions.

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