

What drives investors' decisions?

At the recent Glacier IdeasLab 2020 webinar held on 8 and 9 September, Professor Jaco Fouché from the School of Accounting Sciences at North-West University helped us understand how behavioural economics drives decisions for investors.

Behavioural finance is the study of the influence of psychology on the behaviour of investors and financial analysts. He cautions that investors are not *Homo Economicus*, as embedded in finance theory. This theory posits that, in economic terms, a person has perfect self-interest and access to perfect information. This is simply not true, he says. Investors are not always rational; they have limits to their self-control; and they are influenced by their own biases.

Investors may be backward-looking, sentimental and unrealistic

An example of bias is evident in some investors' belief in previous cases (or stereotypes) of investment performance. Investors may even have an expectation for investments to always perform the same. They may also believe that recent good performance makes a fund manager good or that the longer you participate, the closer you will get to your expectation.

Jaco also drew attention to the fact that our human "propensity for losses is much bigger than for wins – almost twice as big. That means that in the mind of an investor, the possibility of making a loss is twice as powerful a motivator as the possibility of making a gain."

He challenged attendees with three key questions. Does the investor want you to:

1. Sell performing investments soon?
2. Not sell loss-making investments?
3. Take less risk as profits increase or take more risk as losses increase, to try and get even?

He offered some advice regarding getting to grips with investment losses:

- Don't be too focused on the original price and set levels to sell (fair value).
- Discuss items such as standard deviation (risk) on the whole portfolio.
- Show the benefits of diversification.

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