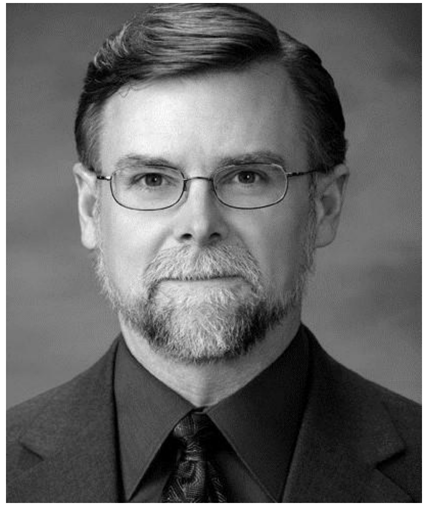
Behavioral bias - Why DIY investing doesn't work

Rob Brown, PhD, CFA

Julex Capital Advisory Board Member, Website www.robbrownonline.com



40 Grove Street, Suite 140, Wellesley, MA 02482

Phone 781-489-5398

Email info@julexcapital.com

Web www.julexcapital.com

Why DIY investing doesn't work

- Numbers - Prove that it doesn't

- Access - DIY folk lack access
- Industry - Encourages DIY folk to focus on all the wrong things
- Nature of Change - Once every 50 year directional change
- Experience and training - What DIY folk lack
- Behavioral bias - We're all human
- Retirement years - Facing a different set of powerful issues

Behavioral bias

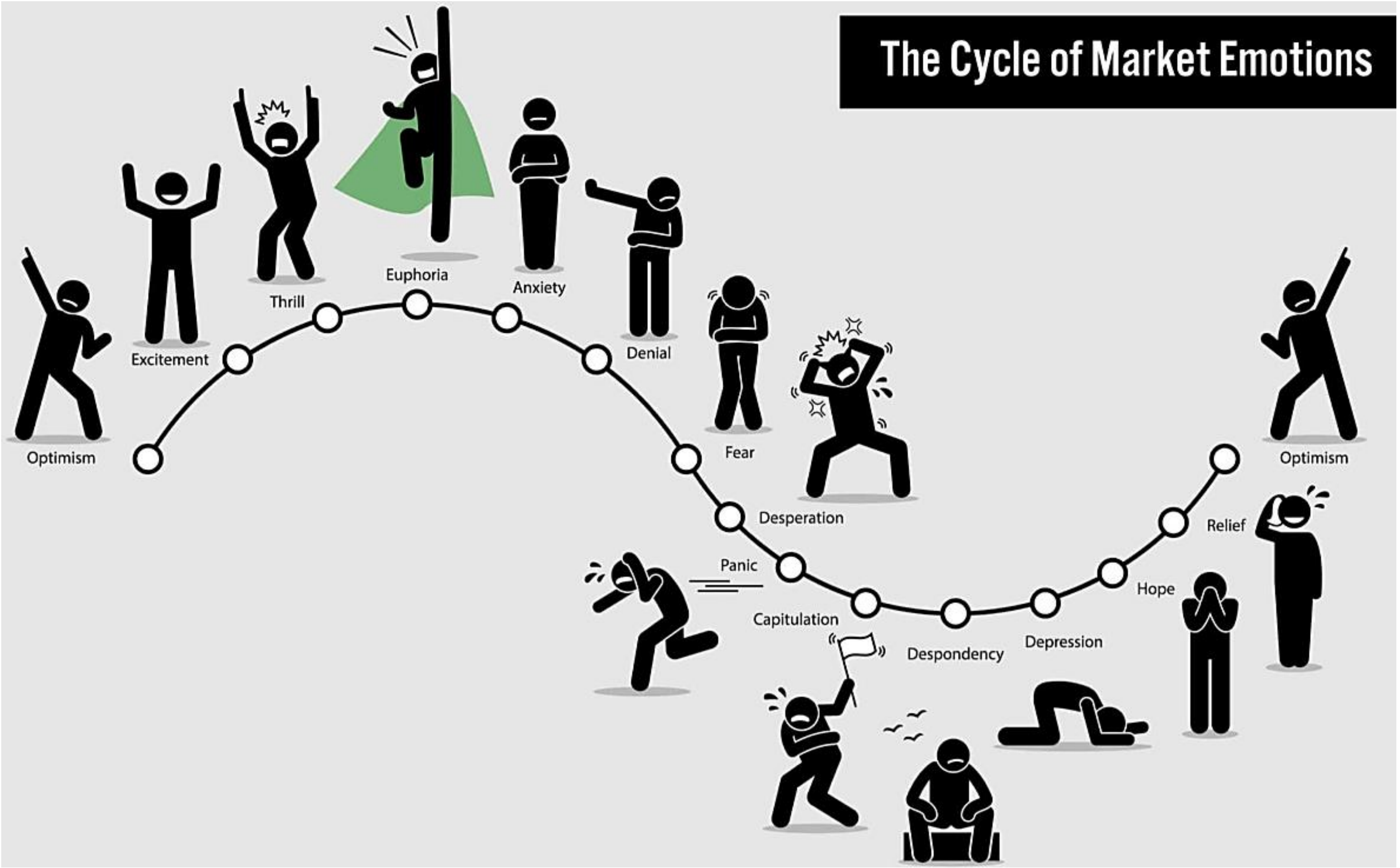
JULEX CAPITAL

- When we . . .

- Allow emotion to interfere with
  - Logic
  - Reasoned judgement
- "Act" instead of "think"
- Allow the animal to decide for us . . . instead of the brain

- We all suffer from behavioral bias . . . we're human
- But . . . successful investing requires that it's kept limited and well under control

Common behavioral bias - Buy high sell low



What causes “Buy high sell low”? - Two behavioral biases

- Trend chasing
- Recency - Hot hand fallacy

Trend chasing

- Believe past performance indicates future performance
- Believe they can “invest in the past”

Recency - Hot hand fallacy

- Because an investment has been climbing higher, you believe that will remain the case
- FOMO - Fear Of Missing Out
- Relying on the latest information and ignoring the greater history
- Feel that winner today will always be a winner
- Your current success becomes the deciding factor for future decisions

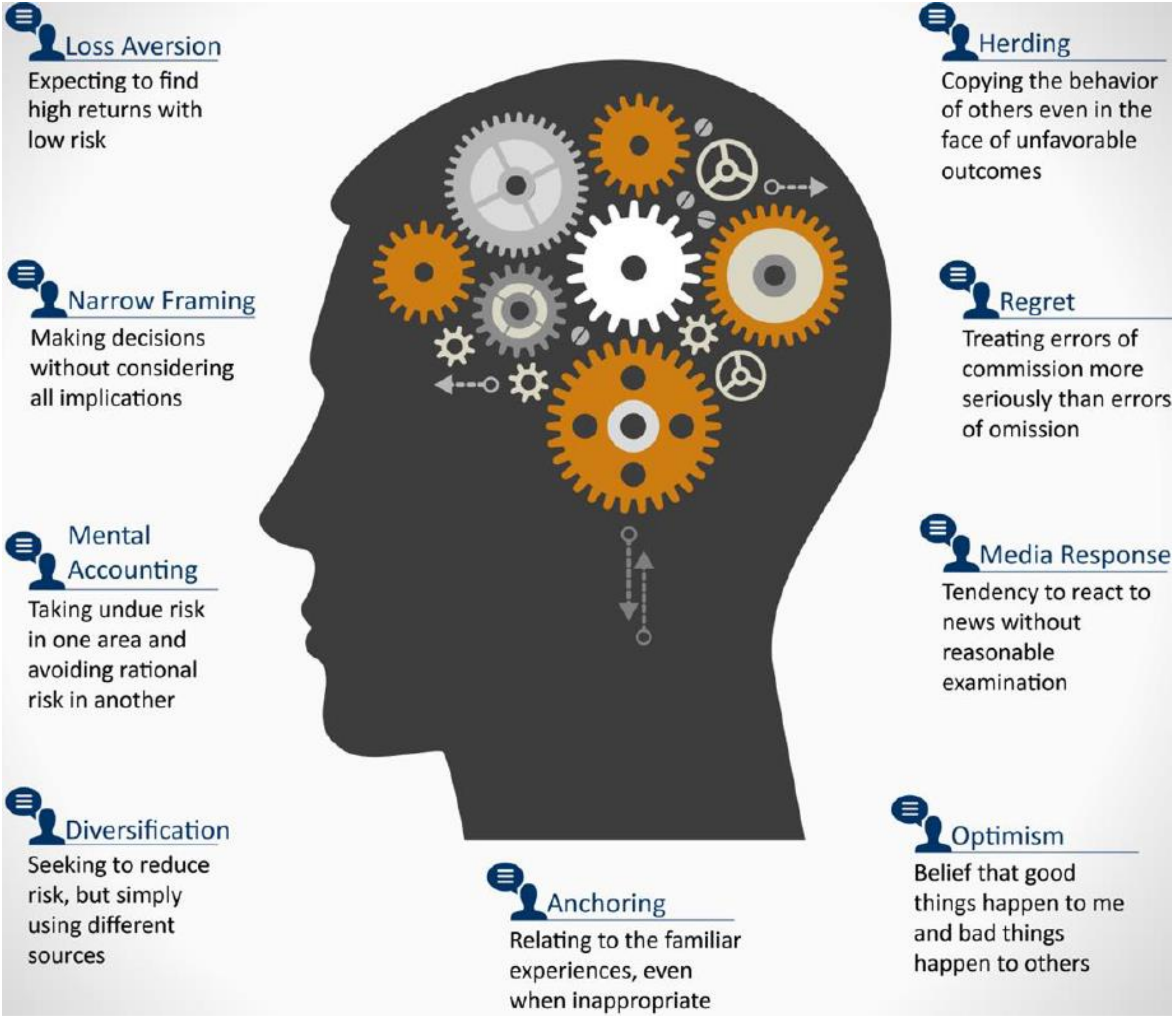
Trend chasing

Believe one can invest in the past

Recency

Recent success decides future decisions

Investing behavioral biases - Nine most common



Loss aversion

JULEX CAPITAL

- Prefer avoiding losses over realizing gains
- Go for low-risk, low-return money market due to stock market volatility
- Feel the pain of loss more than the joy of gains
- Don’t want to live in an uncertain world even if embracing uncertainty leads to tremendous gain
- Humans tend to feel the pain of a loss twice as intensely as the joy of an equivalent gain, often leading to panic selling

Narrow framing

- Also called confirmation bias
- Seeks information confirming current view while avoiding or rejecting conflicting views
- Buy crypto and only interact with supportive information sources and individuals
- Hear only things which confirm what our existing perception
- Makes decisions without considering all of the information and all of the implications

Mental accounting

- Views various sources of money as being different from others (doesn’t realize that money is fungible)
- Example - money earned at a job may be viewed differently than money from an inheritance
- Example - People get emotionally tied to certain stocks. One elderly client wouldn’t part with a large holding of stock in a local bank because it was started by a family member
- Taking undue risk in one account, while avoiding rational sensible risk in another account

Diversification

- Seeking to reduce risk . . . but simply using multiple sources of the same risk

- Confusing number of positions (or securities) with actual risk reduction

Anchoring

JULEX CAPITAL

- Overreliance on familiar experiences or information
- Use of irrelevant information
- Example - you take the purchase price of a security as an anchor (fixed reference point) for making subsequent decisions regarding that security
- Sticking to an initial piece of information to make judgments and decisions regarding the investment
- Ignoring the new information (and reality) that comes along

Optimism

JULEX CAPITAL

- Also called overconfidence
- Believe that they have more knowledge on a certain topic than they actually have
- Two types of overconfidence
  - Quality of information
  - Ability to act on this information for maximum gain
- Misinterpret beginner's luck . . . and consequently overestimate their skill
- Overconfident people often stop (or slow) learning . . . which undermines future performance . . . investors need to be humble, realizing they need to continuously learn about the markets whatever their experience level

Media response

- React to news without adequate examination
- Overestimate the importance of the available information, i.e., the news
- Overvalue a new trend or an idea as discussed in the news, e.g., innovation stocks or crypto
- Allow the irrelevant and unimportant to displace the relevant/important
- Lack of a balanced approach

Regret

- Treating errors of commission more seriously than errors of omission
- Place a higher value on something they own as opposed to something they don’t own
- Won’t selling a bad investment until it regains what it lost
- Not wanting to regret a decision they've made
- Pursue certain behaviors in order to avoid regretting them in the future

Herding

- Moving along with the herd/crowd
- Decisions are encouraged by the herd rather than being based on metrics
- Bernie Madoff, Enron, WorldCom, Meme stocks, SPACs, Crypto
- Herd behavior can create massive bubbles that eventually burst because prices are not justified by the asset but the investors' behavior
- You go with the group because you think the majority cannot be wrong or standing with the majority is a comfortable position

Loss aversion

Irrational risk avoidance

Diversification

Not understanding the source of risk reduction

Media response

Listening to the news

Narrow framing

Restricting your information

Anchoring

Tying yourself to an initial perspective

Regret

Would of, could of, should of

Mental accounting

Treating different sources differently

Optimism

Overconfidence and lack of humility

Herding

Following the crowd

Conclusions

Best limiting the disastrous effects of behavioral bias

Successful mitigation

- Avoid anyone emotional . . . including yourself

Successful mitigation

- Avoid anyone emotional . . . including yourself
- Describe your investment philosophy and investment process
  - In writing
  - In great detail
  - Make sure you adequately describe
    - The explicit investment objective
    - How you will measure success and failure

Successful mitigation

- Avoid anyone emotional . . . including yourself
- Describe your investment philosophy and investment process
  - In writing
  - In great detail
  - Make sure you adequately describe
    - The explicit investment objective
    - How you will measure success and failure
- Identify how it is susceptible to the various forms of behavioral bias
  - It will be . . . no approach can escape these deadly perils
  - Rank order which behavior biases you’re most susceptible to

Successful mitigation

- Avoid anyone emotional . . . including yourself

- Describe your investment philosophy and investment process
  - In writing
  - In great detail
  - Make sure you adequately describe
    - The explicit investment objective
    - How you will measure success and failure

- Identify how it is susceptible to the various forms of behavioral bias
  - It will be . . . no approach can escape these deadly perils
  - Rank order which behavior biases you’re most susceptible to

- Determine mitigation steps
  - Including not managing your own money

For more information contact

Jeff Megar, CFA
Email jeff.megar@julexcapital.com
Office 781-772-1378

Liam Flaherty
Email liam.flaherty@julexcapital.com
Office 781-489-5398

The worst common investment mistakes that investors always make

Friday

February 4th

11:00 a.m. EASTERN

Important Disclosures

All data and statistics were provided by Global Financial Data, Inc. (unless otherwise indicated in the exhibit)

This information in this presentation is for the purpose of information exchange. This is not a solicitation or offer to buy or sell any security. You must do your own due diligence and consult a professional investment advisor before making any investment decisions. The use of a proprietary technique, model or algorithm does not guarantee any specific or profitable results. Past performance is not indicative of future returns. The performance data presented are gross returns, unless otherwise noted.

The risk of loss in trading securities can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. All information posted is believed to come from reliable sources. We do not warrant the accuracy or completeness of information made available and therefore will not be liable for any losses incurred.

Some part of the investment performance shown is HYPOTHETICAL. It is based on the back tests of historical data. Hypothetical performance results have many inherent limitations, some of which are described below. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. In fact, there are frequently sharp differences between hypothetical performance results and the actual results subsequently achieved by any particular trading program.

One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading. For example, the ability to withstand losses or adhere to a particular trading program in spite of trading losses are material points which can also adversely affect actual trading results. There are numerous other factors related to the markets in general or to the implementation of any specific trading program which cannot be fully accounted for in the presentation of hypothetical performance results and all of which can adversely affect actual trading results.

The composition of a benchmark index may not reflect the manner in which a Julex portfolio is constructed in relation to expected or achieved returns, investment holdings, portfolio guidelines, restrictions, sectors, correlations, concentrations, volatility, or tracking error targets, all of which are subject to change over time.

No representation or warranty is made to the reasonableness of the assumptions made or that all assumptions used to construct the performance provided have been stated or fully considered.