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Emotional Investment

Do ego and emotions play a role in determining investment or the price one pays for items, such as stocks, companies, and art works?

One way to look at the role of ego in price determination is to observe an art auction. Certain bidders go to irrational price levels for a particular artist and his artwork which they “have to have at all cost.” Art investment is one way to understand the ego effect on purchase price since price in this case has little correlation to the cost of the product (like paint, canvass, artist’s time, and frame). Buying art is 70% emotion and what other collectors say. It’s definitely not a basic must-have commodity.

Emotional investment resides in “gut feel” that can overcome all rational and analytical indicators. If a tycoon feels he “has to have a company (and its controlling stocks) at all cost”, the acquisition team just has to fall in line. Accountants who do not get swept up by emotions book the difference between the financial value of a business and its actual purchase price under the vague category of “goodwill.”

The aggregate version of using emotions to make financial decisions is captured by “market sentiment.” This is a term stock analysts use to explain price fluctuations that statistics and financial ratios alone cannot account for. Investor mood is described as bearish, bullish, or cautious, which is sometimes called “hopeful pessimism”, when investors are not paying attention and staying in the sidelines, maybe sipping café latté. In a surge of exuberance, the sentiment is described by the Keynesian phrase “animal spirits.”

Sentiment is not entirely psychological as it is also driven by statistics on growth, inflation, exchange rate, and presidential pronouncements, in addition to insider info, corporate rumors, feng shui, and the season of the year like ghost months or Santa rallies.

While some criticize foreign funds (aka “hot money”) for they are too ready rush to the exits when sentiment turns, we need to appreciate them too for bringing attention, and funds, into our equity market, sometimes accounting for half of the daily value of shares traded.

In a small market like ours it is easy to understand the role of emotions and the same vagaries of sentiment applicable to an art auction. Sometimes too, belief in a stock can turn into a self-fulfilling prophecy if the emotional investor has a deep enough pocket to back up his mood, and continues averaging down. He may convince colleagues to follow suit.

It is best to reboot your thinking about stocks and life. Here are some suggestions that apply to emotional investments.

Re-price your acquisition costs to the closing prices of your stocks on the first trading day of 2017. You can forget the actual average cost and just leave behind the sorrows of previous years. This artificial revaluation of cost presumes that you already took the losses or gains on your stocks at the end of last year, and now starting fresh. Of course, we know that gains and losses are only realized when stocks are sold. Personal portfolio valuation is anyway just a way of keeping score, a variation of the marked-to-market accounting used by banks and funds. By artificially re-computing your cost, your attachment (and loss aversion) stemming from the actual cost of your portfolio is forgotten. This year is the first day of the rest of your investment life. The move will give you less angst in managing your personal portfolio.

If you can't understand what you are being asked to invest in, walk away. Too often, you trace your inability to comprehend complex investment instruments like "accumulators" and "leveraged funds" to ignorance and a lack of financial savvy. (Can you read a pie chart?) Hey, it's your money so you should know what you're buying. If an instrument cannot be explained to you in three simple sentences with subjects and predicates and no fine print, just buy a car. At least you can get stuck in traffic in it.

Cash is just another asset. It's not a complicated thing to just sock money in a savings or current account or put it under your pillow. But look to the Gospel. You're not supposed to bury your talents. You still need to strive for yields and make your money grow. If cash is king, guess who the slave is.

Do not be envious of other investors. It's a casino rule that players only talk about their winnings. So, those who boast about making enough money to buy the property next door from stock profits usually avoid talking about their losses. Any form of "Pennies Envy" should be shunned.

Concentrate on what you have left. It is unproductive to think of the millions you lost or could have made, when you just have hundreds of thousands left. This remainder still needs to be nurtured and invested too. Sure, the numbers are smaller and less exciting. But anything larger than zero or an amount inside a parenthesis is cause for celebration, even if it just buys a buffet lunch.

Take care of living expenses. Investments should only involve discretionary funds left over from tuition fees, utilities, and meals. It is not wise to dip into household budgets for investment. (Only the government can use "savings" for frivolous things.) By definition, investible funds are subject to being locked in for the long term or even getting lost.

Do not look back. It's better to look through the windshield rather than the rear view mirror. You can get into accidents that way. It's best to move forward and if you still have problems, they should be new ones. So what if you sold too soon a stock that kept going up and became the best performer of the year. It's best not to compute the money you could have made if you had held on another six months.
You don't have to wait for the bottom. The concept of a price floor is relative. It's fine to buy above the bottom if the price can still appreciate. The bottom is not an absolute amount. If you can sell at a higher price than you bought, does the bottom really matter? Yes, it does.

Collectors of paintings are told to buy what they like, not what they can get in a resale. Art is meant to be enjoyed. This rule does not apply to investments. Emotional attachment to stocks, even as they turn into lemons, can be risky. Even for losing stocks, heartlessness helps. Take the loss and then move on, hopefully to a more promising alternative like a condo unit…in the secondary market.

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