Money and Your Mind

Mark Rylance, CFP®

RS Crum, Inc.
Money & Your Mind

• Part 1: Are we good investors?
• Part 2: What about us makes investing difficult?
• Part 3: What do we need to do to be better investors?
We are not rational about money!

• We spend more when we use credit cards instead of cash. (15% more!)
• We buy things on impulse we don’t need. We confuse “wants” and “needs” when it comes to spending money.
• We assume if the stock market has been going up, it will keep going up. And if has been going down, it will keep going down.
Why are we irrational?

• We lack knowledge.
• We lack discipline.
• But, we also have brains that are wired in a way that causes trouble with our investing.
Investor Report Card

Returns for average equity and fixed-income investors calculated by DALBAR. DALBAR uses data from the Investment Company Institute (ICI), Standard & Poor’s, Bloomberg Barclays Indices and proprietary sources to compare mutual fund investor returns to an appropriate set of benchmarks. The study utilizes mutual fund sales, redemptions and exchanges each month as the measure of investor behavior. These behaviors reflect the “average investor.” Based on this behavior, the analysis calculates the “average investor return” for various periods. These results are then compared to the returns of respective indexes. Ending values for the indexes and hypothetical equity and fixed-income investor investments are based on average annual total returns.
"Wow, am I Smart."

"Temporary Set Back - I'm A Long Term Investor."

"How Could I Have Been So Wrong?"
Our actions hurts performance

Performance of the S&P 500 Index, 1970-2013

Missing only a few days of strong returns can drastically impact overall performance.

<table>
<thead>
<tr>
<th></th>
<th>Annualized Compound Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Period</td>
<td>10.40%</td>
</tr>
<tr>
<td>Missed 1 Best Day</td>
<td>10.13%</td>
</tr>
<tr>
<td>Missed 5 Best Single Days</td>
<td>9.33%</td>
</tr>
<tr>
<td>Missed 15 Best Single Days</td>
<td>7.99%</td>
</tr>
<tr>
<td>Missed 25 Best Single Days</td>
<td>6.86%</td>
</tr>
<tr>
<td>One-Month US T-Bills</td>
<td>5.17%</td>
</tr>
</tbody>
</table>
Vanguard study shows we receive lower returns than the funds we invest in.
Recent Nobel Prize Winner

Dr. Richard Thaler
University of Chicago, Economics

1.) Two types of people: economists and humans.
2.) The humans think like humans, economists don’t!
3.) Humans are impatient, inconsistent, and distracted by irrelevant factors.
4.) Financial behavior is largely a problem of self-control.
Behavior Gap by Carl Richards
Money & Your Mind

• Part 1: Are we good investors?
• Part 2: What about us makes investing difficult?
• Part 3: What do we need to do to be better investors?
Evolution of our Brains
The 3 Brains

Neocortex
Human Brain
Logic/Abstract Thought

Limbic System
Mammalian
Emotions/Empathy/Parental

Reptilian Complex
Survival/Reproduction
AIRCRAFTS

UNITED AIRLINES 12.20 [-14.78%]

UNITED AIRLINES 32.63 [-21.64%]

UNITA AIR LINES 31.85 [-16.98%]

SOUTHWEST AIR 37.43 [-9.33%]

BLUE AIRWAYS 9.64 [-13.82%]

UNITEDHEALTH, APPLE, BOEING CUT 200 POINTS EACH OFF DOW
Trouble from the feeling brain

The **amygdala** in the limbic system is the **control center of emotions**.

- We let emotions take over.
- We think more information is better.
- We take mental shortcuts.
- We are influenced by the media.
System 1
Fast, intuitive and emotional

System 2
Slow, conscious and effortful
“Salt and _______”
2 + 2 = ________
System 1

Fast, intuitive and emotional

System 2

Slow, conscious and effortful
17 \times 24 = ?
We think more info is better

Sometimes we think if we just do some more research or reading or get another adviser’s opinion, we will finally know what to do.

However, we usually we get overwhelmed by too much information.
We take mental shortcuts

We get overwhelmed by data, so we use shortcuts.

We can only analyze 5-9 variables, at a maximum.
Heuristics
THE CONFIRMATION BIAS

WHAT THE FACTS SAY

WHAT CONFIRMS YOUR BELIEFS

UNDERVALUED

OVERVALUED

FOOLISH

JamesClear.com
THE AVAILABILITY HEURISTIC

WHAT ACTUALLY HAPPENS IN THE WORLD.

Covered in the news.
THE SURVIVORSHIP BIAS

Forgotten

Remembered

JamesClear.com
We take mental shortcuts

We go with what others are doing and thinking.

This is herding bias.
Experiences & Luck
Money Scripts
PRICE REDUCED
FORECLOSURE
BANK OWNED
We are influenced by the media
INVESTING

ENTERTAINMENT

A BAD IDEA

behaviorgap.com
The Media Sells Greed

• The investment entertainer Jim Cramer has used the following tag line for marketing his books, TV shows, and podcasts. He says…

“You Can’t Afford To Miss It!”

“You’ve Got To Get In The Game!”
The Media Sells Fear

- It’s a **blood bath** on Wall Street today!
- The financial markets are in **freak-out mode**!
- The company is **too big to fail**!
- The stock market is **crashing**!
The Media To The Rescue

• Jim Cramer was famously interviewed in February, 2009, and stated that investors should sell enough investments so that they had all the cash they needed for 5 years.

• Guess what happened a month later...
S&P 500 (^GSPC) - SNP ★ Follow
1,894.36 +6.33(0.34%) 1:06PM EDT

Week of Oct 10, 2011: ^GSPC 1224.58

5 Years Later...

Cramer appears on Today.

S&P Total Return = 88%
Annualized Return = 17.6%
If you had invested in all 10 stocks, you would have had a return of **-46.6%** over those ten years.
What’s New

Version 9.39.0  2d ago

Here’s what’s under the hood in our latest update:
- Bug fixes and improvements
Investing
$4.81
▲ $0.102 (2.17%) Today

Buying Power
$0.00

Robinhood Update 15h
We've removed all temporary position limits, including...
Investing
$4.67
▼ $0.0579 (1.22%) Today

Buying Power $0.00

Start a recurring investment
Start investing for the long-term—all you need is one minute and $1 to get...
GET STARTED
Congratulations!

You now own 1 share of SPPI worth $3.83.
Invite a friend. Get a free stock.
Invite friends to Robinhood. Once they sign up and link their bank account, you’ll both get a free stock.

✦ **100% chance to get a free stock**
Each time a friend signs up and links their bank account, a new stock appears in your account (up to $500). Certain limitations apply. [Learn more](#)

✦ **Unlimited invites**
Invite as many friends as you want and receive up to $500 in free stocks.

[Invite contacts](#)
[Share link](#)
Money & Your Mind

• Part 1: Are we good investors?
• Part 2: What about us makes investing difficult?
• Part 3: What do we need to do to be better investors?
Removing Emotion

- Investment Policy Statement
- Ask Additional Questions:
  - Entertain competing hypothesis
  - What would the opposite look like?
- Seek out people who like you, but don’t care about your feelings
- Don’t trust people, trust algorithms
What do we need to do?

To be better investors, we need these six things:

1.) **Discipline:** write down your investment strategy.
2.) **Diversification:** have a variety of investments.
3.) **Allocation:** create a plan for your variety of investments.
4.) **Rebalancing:** at least twice a year, get back to targets.
5.) **Minimize costs:** save money on fees and taxes.
6.) **Accountability:** select the right kind of advisor.
1.) Discipline: follow a disciplined investment strategy.

Dr. Thaler wrote with Dr. Sholomo Benartzi of UCLA business school…

“Investors hate losses more than they love gains, and they focus too much on the near term, even when it comes to long-term investment goals, like retirement.”
1.) Discipline: follow a disciplined investment strategy.

Even a short, written plan will decrease worry.
Carl Richards
2.) **Diversification**: you need a variety of investments.
2.) **Diversification**: you need a variety of investments.
3.) **Allocation**: the variety plan is the most important decision.

This is just an illustration of a portfolio allocation. It is not a good allocation for your portfolio.
3.) **Allocation**: the variety plan is the most important decision.

![Asset Allocation vs. Security Selection: What's Really Important?](image)

Asset Allocation is the most important decision and determines over 90% of an investment portfolio's long-term returns and short-term volatility:

- **Asset Allocation**: 94%
- **Security Selection**: 6%

4.) **Rebalance**: at least twice a year, get back to targets.

Sell 10% bonds
Buy 10% stocks
5.) **Minimize costs**: save money on fees and taxes.
6.) **Accountability**: select the right kind of advisor.

- Ask First!
- What is their experience?
- What is their education?
- Are they licensed to sell you something?
- How do they get paid?
- Are they held to the fiduciary standard?
National Association of Personal Financial Advisors (NAPFA)

Websites:

Comprehensive Financial Advisor Checklist

Additional Napfa Resources
What else should we do?

To be better investors, we need these six things:

1.) **Discipline**
2.) **Diversification**
3.) **Allocation**
4.) **Rebalancing**
5.) **Minimize costs**
6.) **Accountability**
THANK YOU!!

Mark Rylance

RS Crum, Inc.
mark@rscrum.com
949-428-9696
www.rscrum.com