

## **This Month**

This month we have quite a bit from the Applied Behavioral Finance Board members. First is a review by Larry Brody (board member) of Richard Peterson's (board member) new book. Our group is not just about "Gee Wiz, isn't behavioral finance cool", it's about how to apply it in the financial world. So starting this month, we'll have regular short articles from our board members about how they use behavioral finance in their business practices. First up is John Weisickle.

## **Larry Brody's Review of *MarketPsych: How to Manage Fear and Build Your Investor Identity* (Wiley Finance) (Hardcover) by Richard Peterson and Frank Murtha**

MARKET PSYCH is a book for investors, which can give you a level of protection that a financial professional may not be able to offer. Through the ages dating back to Ancient Greek philosophers, mankind has been encouraged to "know thyself." Nevermore important in the mysterious mechanism of investing has it been so important to know one's self. And this admonition has been repeated throughout history. Even Clint Eastwood has opined, "A man's got to know his limitations."

The investment world as the authors point out could be given the nomenclature of the speculative world more accurately. You are playing with the house, and the house has all the advantages, although many people "invest" to have something to talk about whether buying speculative stocks, bonds or real property most of us have to invest in order to have funds to live on after our productive employment years come to an end. In truth it is a much more serious matter, and most people know that Social Security will no longer support the golden years. So it will be up to you. That's why the fortunate readers of this book have the opportunity to gain advantage. It is a chance to refine one "self" as a tool in managing one's future.

I have often wondered how the name "securities" came about, when I learned from Helen Keller, in reality, there is no such thing as security.

"Security is mostly a superstition  
It does not exist in nature  
Neither do the children of men  
Experience it often

## **Newsletter**

This is a monthly newsletter from the Applied Behavioral Finance Group (ABFG), An Associated Group of the CFA Society of Los Angeles, CA.

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## **Mission**

To identify, evaluate, and disseminate information and activities in the field of behavioral finance. Our objective is to enhance collaboration between research and practitioners in order to produce practical applications of value for investors and professionals who serve them.

## **Website**

[www.abfgla.com](http://www.abfgla.com)

Avoidance of danger is no safer in the long run  
Than outright exposure  
Life is either a daring adventure or nothing"

The authors, Peterson and Murtha attack this issue directly addressing the fear that most investors, individual or profession have suppressed to either conscious or unconscious fear, which impairs their judgment on an issue so critical to one's future.

I think this book is essential for so many who rely on their own overconfidence to take them through to a "secure future." I think anyone planning a trip to the jungle or climbing a mountain, or even taking a vacation, would want to rely on and hone their own judgment in planning a venture with some degree of risk.

This book lays out chapter by chapter the steps needed to optimize your investor

Self-awareness. It is pretty common knowledge that many talented people wind up in the poor house at the final chapters of life having lived short term comforts. It is also known that it is hard to see your own self, let alone identify your blind spots and be able to work on them. In this world, one will need a lot of fore-vision to come out whole. Even highly trained psychiatrists and psychologists I have known, have their blind spots, despite their expertise in their professional field. They are no match for the investment professional.

Furthermore, our culture has evolved to accept both willful and naïve deception and lying as part of the acceptable culture. It is possible that a trusted and honest advisor could also be deceived. So then the book comes back to you're as an investor to hone your own self through self-awareness. And, therefore your identity as an investor has to evolve, and you will know what you are doing to your "self" and your loved ones, all the better.

I found the common sense approach of the book allowed them to take my hand and gently guide me through the steps toward identifying repressed fear and towards a more confident identity as an investor/speculator. To me, the importance of this book is even more important as government evolves as an entity to take from your rather than to provide for you. Ask a young person what they expect to get from government or Social Security!

Furthermore the pressures of media and the parade of experts in finance offer potential confusion. Who do you follow or should you avoid joining the "herd" or just bury your head in the sand. I liked

Chapter 2 on Investor Identity. The easy examples and analogies crystallize the concepts and points the authors want to impart to the reader. This gets you thinking about your "self", your goals and where you want to go and the "risks" rather than the rewards of how you get there. It's all important and worth consideration.

One thing I found helpful, is the many questions that the authors ask the reader to contemplate. Rarely does one ask questions of themselves, but asks questions about the investment. To me, this is quite important and one of the elements that differentiates the approach of this book from the many other " Behavioral Finance" books I have read.

I don't want to steal the thunder of this book, but the authors have the ability to understand the reader and his/her limitations as a player in the investment/speculation world. You have to read it and put yourself into it, and be willing to examine yourself. The authors know the investment world and the people world, and can help you to understand your identity as an investor.

This book, in contrast to others I have read on investing will prepare you to be a more effective self in the investing/speculating world. It can also be read and applied by investment professionals. An old axiom of the investment world, like "customer's man" and " know your customer" have now evolved into "know your investing self" thanks to these kind and brilliant authors.

The authors use a method similar to the Socratic, to teach through self examination. The reader has to be thinking and answering questions rather than just passively reading this book. This publication will pay great dividends for the willing reader.

This book is a big winner.

### **John Weisickel on Behavioral Finance in the Corporate World**

ERISA (Employee Retirement Income Security Act) is the body of law that governs Pension plans that are created by corporations. ERISA does not mandate that corporations create pensions for their employees, but if a corporation does so, then ERISA determines how the corporation will manage its pension plan. An example of an ERISA directive is that a corporation must appoint a fiduciary to assume the duties of investing the assets of the pension in the same manner as a "prudent man" would. Generally this means

diversifying investments so as to minimize the risk of large losses, unless under the circumstances it was clearly prudent not to do so.

Some years, if not decades, ago, before I retired from Honda, I acted as one of the financial fiduciaries for the company's pension plan. This was at a time when it was not uncommon to read about banks losing millions, even tens of millions, of dollars due to unauthorized trades, usually by foreign exchange traders. Even in Los Angeles, a major home builder reported losing \$15 million due to unauthorized trades in the futures market by one of its lumber buyers. The experience of those institutions was not lost on us at Honda. We saw the effect that hubris had on financial decisions, and decided to make certain that our administrative structure reflected key principles from behavioral finance. First, we confirmed that we had a pension committee that included all of the pension plan fiduciaries, even those responsible for none-financial decisions. This committee would meet regularly, i.e. once per month, and a quorum had to be present before any decisions regarding the pension, especially financial decisions, could be made. That would insure transparency: all decisions had to be made, essentially, by a vote of all the fiduciaries. Secondly, we employed a financial advisor who would be present at all the pension meetings to provide advice, conduct periodic studies on asset allocation and assist in the selection of money managers. That would insure objectivity, and would protect the less financially astute members from manipulation by the more professional ones.

In the end, I'm not sure how much of what we did would have been mandated by ERISA in any case, but the point here is that through awareness of lessons from the behavioral finance field, we were able to implement not only the regulations of ERISA, but also the spirit of those regulations.

### **Websites/Links of Interest**

**Abstract from Victor Ricciardi in the book '*The Psychology of Risk*' by Baker and Nofsinger**

[Psychology of Risk](#)

**Subjective Probability, Utility and Decision Making Conference, August 21st in the UK, call for papers and registration**

[Spudm23](#)

## Journal of Behavioral Finance Website

[Journal Link](#)

### **Upcoming Events**

#### **Meir Statman - March 15th, 12:00pm, Omni Hotel**

Dr. Statman will be doing a presentation about his new book, ***What Investor's Really Want***. It's a highly readable book about all the ways that investors aren't the rational beings that classic economics say they should be. We'll have a review of the book next month. As of now we don't have the registration link for sign up. It should be available by mid-January. You can check for it at the CFA Los Angeles website, at: [CFA Los Angeles](#)

### **Editor's Invitation**

Please write with any ideas, articles, rants, raves about our newsletter etc. to: Editor, Applied Behavioral Finance Digest to: [editor@abfgla.com](mailto:editor@abfgla.com)

We also invite you to view our website, [www.ABFGLA.com](http://www.ABFGLA.com) , and share your thoughts and ideas.