

AGENDA



Behavioural Investing:

This presentation will cover how investors think about investing and why every trader is different. Understanding who you are as a trader will improve your effectiveness. For example, not all traders will be able to trade the Elliott Wave Theory or short-term swing trading because they are not wired to think that way while others will be very successful at it.

AGENDA



We will introduce some of the documented biases that investors face and apply real life market scenarios. Currently, the body of knowledge in this area is extensive in the academic world, but scant in the technical world. Our hope is to expand the BOK in this area as it is quickly becoming an important contributing success factor for many market participants.

A PENNY FOR YOUR TWEET



3

Tim Ely @stockscoder · 22h

@LarryBermanETF Your calls on energy and banks have been on point. I'm sold on your stock technicals techniques and starting to learn.

12:11 PM - 2 Oct 2014 · Details

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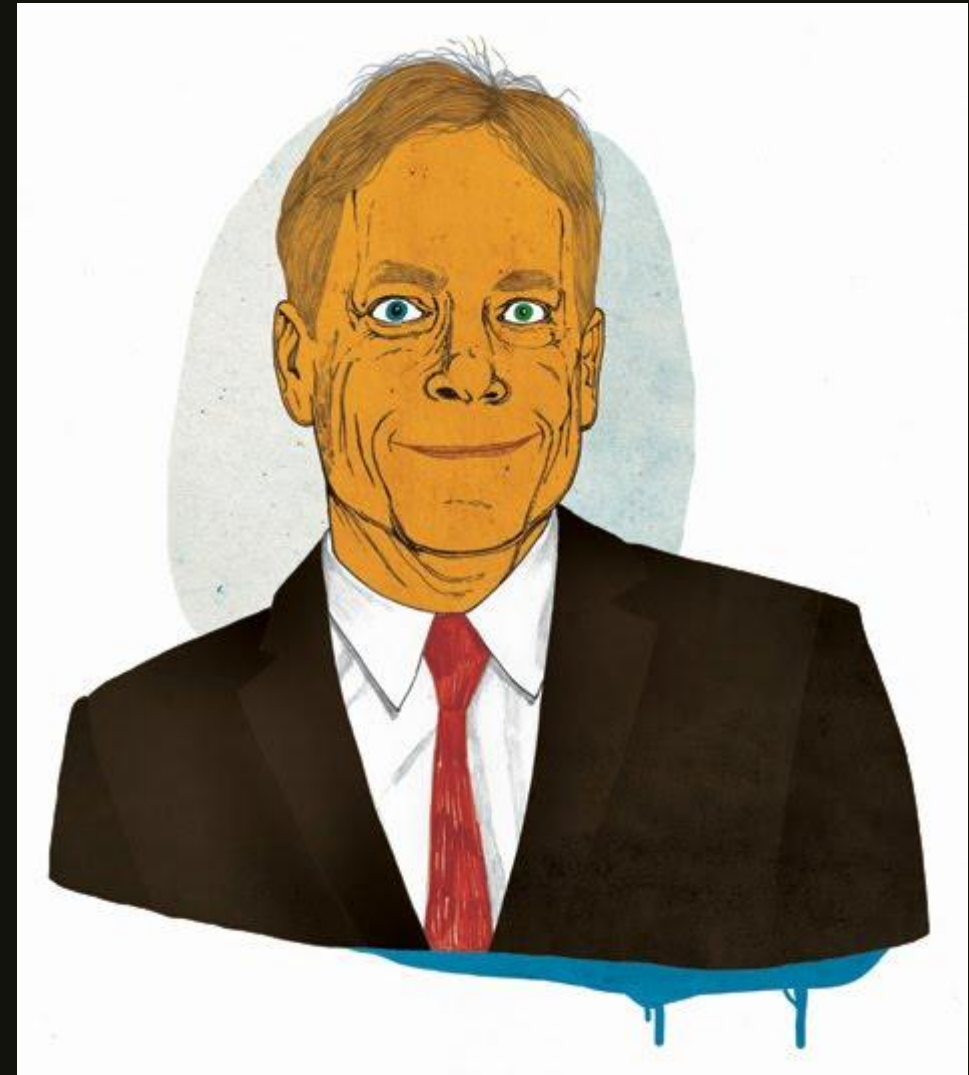
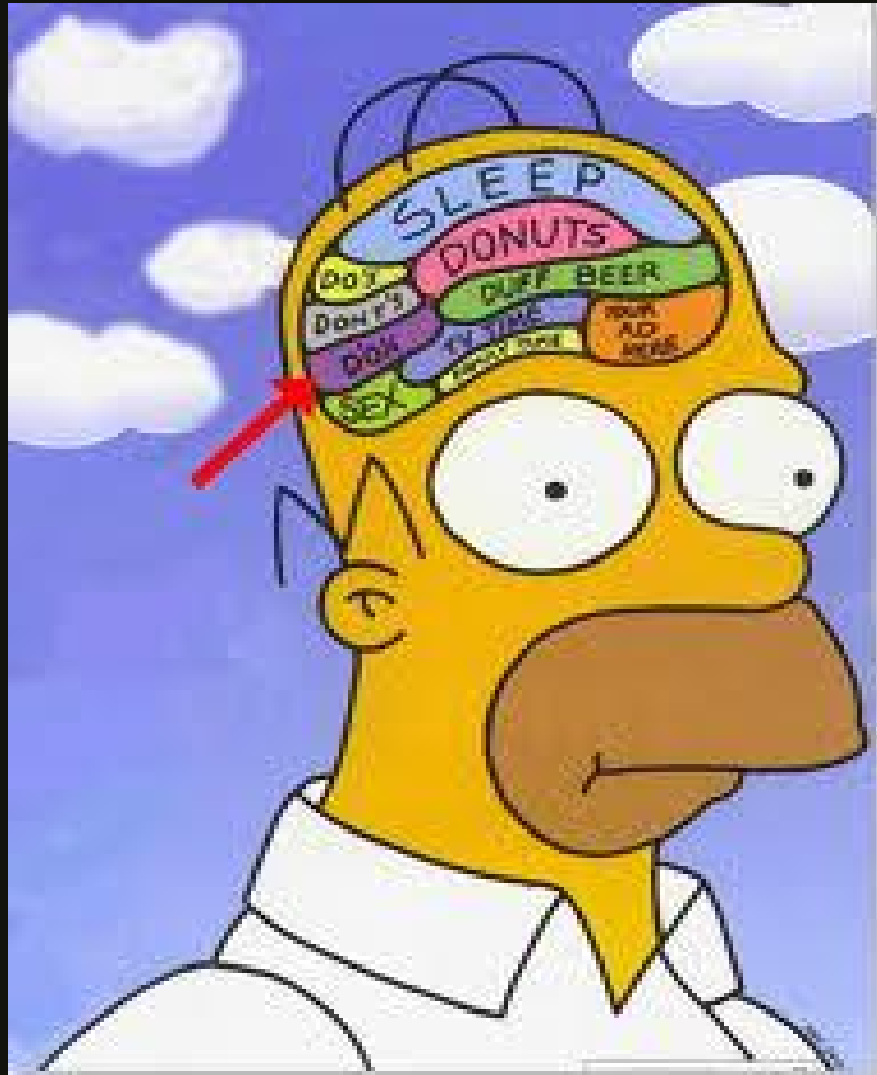
Statistically, this guy is sold on me getting 2 calls right out of 2 calls. If both calls were wrong he may have dismissed me a fool. His logic is completely flawed and he is likely doomed as a trader. He suffers from some biases we will cover today.

WHO CAN READ THIS?



If yuo cna raed tihs tehn
yuo aer in teh grpoue of
pelpoe taht hvae the alibity
to be a sufccessul tardre.
Yuo aer porblbay a
tchenilce alnasyt.

HOW WE THINK ABOUT INVESTING IS EVERYTHING



ARE YOU A HOMER OR DO YOU HAVE A RULES BASED PLAN?



WHAT DO YOU THINK ABOUT WHEN MAKING AN INVESTMENT



ARE YOU ON THE RIGHT SIDE OF MARKET EMOTIONS?



WARREN BUFFET SAYS



“Success in investment doesn’t correlate to IQ once you are above the level of 100. Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble in investing”.

“Investors should try to be fearful when others are greedy and be greedy only when others are fearful.” That turns out to be excellent advice, according to the results of a new study that looked at the brain activity and behavior of people trading in experimental markets where price bubbles formed.

<http://www.sciencedaily.com/releases/2014/07/140707152526.htm>

Therefore, we must be aware that willpower alone is not enough to control your emotions. After a few times maybe you have used all your willpower 😊

THE FACT IS, OUR WILLPOWER WILL DECAY OVER TIME!!!

UNDERSTANDING HOW THE BRAIN WORKS



- The experiment: 20 participants told how trading worked.
- 100 units currency and 6 shares of the risky asset. 50 trading periods, pressing buy, sell, or hold buttons
- The fundamental value of the risky asset was 14 currency units. The traded price rose well above that -- sometimes three to five times as high -- creating bubble markets that eventually crashed.
- 2/3 subjects per session also participated under fMRI
- First analyzed behavioral data before analyzing the fMRI scans.
- Even where you don't have squawking heads and other information being fed to people you can get bubbles
- 3 categories based on earnings: low tended to be momentum buyers. middle didn't take many risks. high bought early and sold when prices were on the rise.
- Emotionally, they have to do something really hard: sell into a rising market. Something must be going on in their brains that gives them an early warning signal.

UNDERSTANDING HOW THE BRAIN WORKS



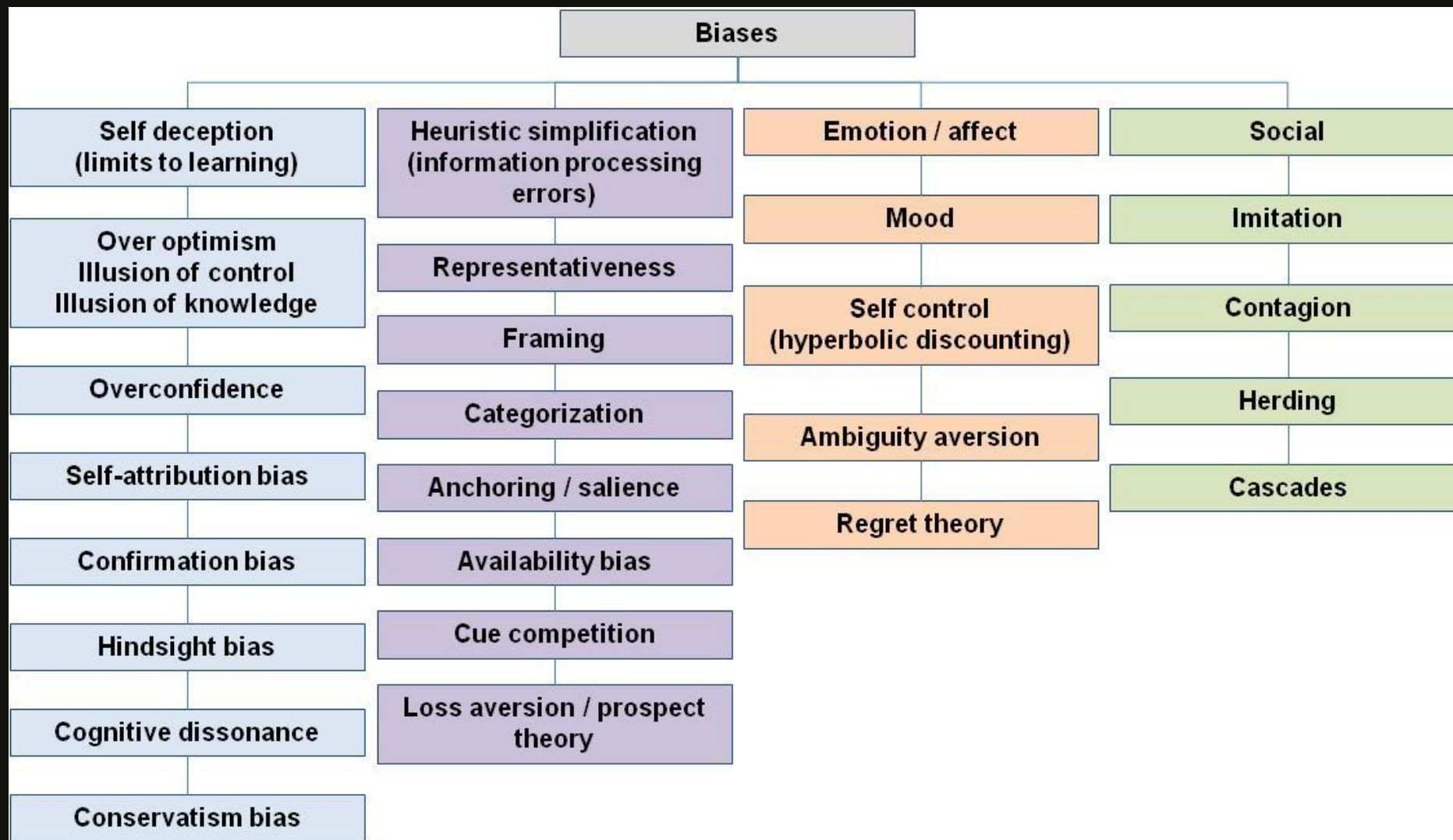
- Nucleus Accumbens (NAcc) lit up at that time in all participants, showing more activity when shares were bought or sold. The NAcc is associated with reward processing -- it lights up when people are given expected rewards
- Low earners were very sensitive to activity in the NAcc: when they experienced the most activity in the NAcc, they bought a lot of the risky asset. "That is a correlation we can call irrational exuberance,"
- High earners low sensitivity to the same brain signal. Even though they're having the same mental reaction, they're not translating it into buying as aggressively.
- Studies had linked insula it to financial uncertainty and risk aversion. It's known to reflect negative emotions.
- High earners insula activity increased shortly before the traders switched from buying to selling.
- Low earners insula activity actually decreased allowing irrational exuberance to continue unchecked.

SELF-AWARENESS IS THE KEY NOT A NEW INDICATOR



- **The Market is Smarter than You!**
- Do you look at your account value daily, weekly, monthly, quarterly, annually?
- We all have our own battle with Fear & Greed – Honesty is key
- You must develop a plan that overcomes emotion to work towards a probabilistic model.
- We are all capable, we are largely unaware of our capabilities. “Learn or Die” from your mistakes.

SOME OF THE BIASES WE NEED TO UNDERSTAND



I KNOW THAT I CAN'T BUY THIS AND STAY WITH THE TREND



PSYCHOLOGICAL PITFALLS INVESTORS FACE



Overconfidence

ARE YOU OVERCONFIDENT?



- 1. Are you a better than average driver?**
- 2. Are you a better than average worker?**
- 3. Are you a better than average lover?**

OVERCONFIDENT INVESTORS HAVE TROUBLE TAKING LOSSES



LOOK TO RELATIVE STRENGTH ANALYSIS TO REDUCE EGO



BP/ LN Equity (BP PLC)

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PSYCHOLOGICAL PITFALLS INVESTORS FACE



Show me what I want to see
(Confirmatory Bias)

DO YOU LOOK FOR OTHERS TO CONFIRM YOUR OPINION?



- 1) The best investors are correct 55% of the time.**
- 2) Do you disregard other opinions?**
- 3) Do you care what other people think of your investments?**
- 4) Why? You do not have a plan!**

THAT ANALYST AT GOLDMAN SACHS AGREES WITH ME



September 15, 2014

ACTION

Sell

TransCanada Corp. (TRP.TO)

Return Potential: (13%)

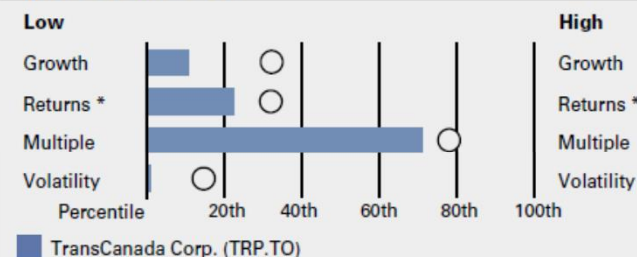
Equity Research

Downgrade to Sell, low growth and high valuation vs. peers

Source of opportunity

We downgrade shares of TransCanada (TRP.TO/TRP) to Sell from Neutral with 10% total return downside to our C\$52/\$47, 12-month target prices vs. 13% average upside for C-Corp peers. TRP has outperformed large-cap peers by 12% since the end of 2Q14, partly driven by investor views of break-up potential. Our SOTP suggests this thesis is overdone at current valuation given (1) fundamental headwinds in its core natural gas pipeline business and (2) excessive optimism over its backlog given sub-10% returns on 2/3 of its projects and elevated regulatory and execution risk. TRP shares appear expensive on various metrics after recent outperformance.

Investment Profile

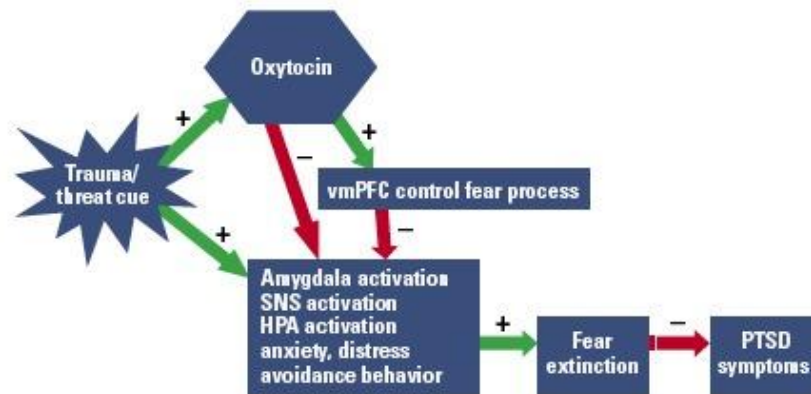


* Returns = Return on Capital For a complete description of the investment profile measures please refer to the disclosure section of this document.

FMRI REVEALS IT'S ALL EMOTIONAL (OXYTOCIN)



FIGURE 1.
Modulation of the fear response by oxytocin ("fear system")



vmPFC=ventromedial prefrontal cortex; SNS=sympathetic nervous system; HPA=hypothalamic-pituitary-adrenal system; PTSD=posttraumatic stress disorder; +=stimulating; -=inhibiting,

Olff M, Langeland W, Witteveen A, Denys D. *CNS Spectr*. Vol 15, No 8. 2010.

- Higher levels of oxytocin are associated with decreases in stress and anxiety and facilitation of extinction of conditioned avoidance behavior.
- Studies indicate that oxytocin affects amygdala activation.
- Oxytocin, creates confidence by stimulating the part of the brain responsible for confidence production the Ventro medial prefrontal cortex, simultaneously blocking another part of the brain the Amygdala from producing a response to fear and doubt.

PSYCHOLOGICAL PITFALLS INVESTORS FACE



Heads was skill tails was bad luck
(Self Attribution Bias)

DO YOU LEARN FROM YOUR MISTAKES?



- 1) Do you blame others for your losing trades?**
- 2) Do you brag about your winning trades?**
- 3) Do you argue about market views with others?**
- 4) Get rid of the EGO. It will hurt your results.**

THAT GUY AT GOLDMAN SACHS WAS &!#% WRONG



HOW MANY OF US HAVE THESE ISSUES?



Taking profits quickly?

Selling too late?



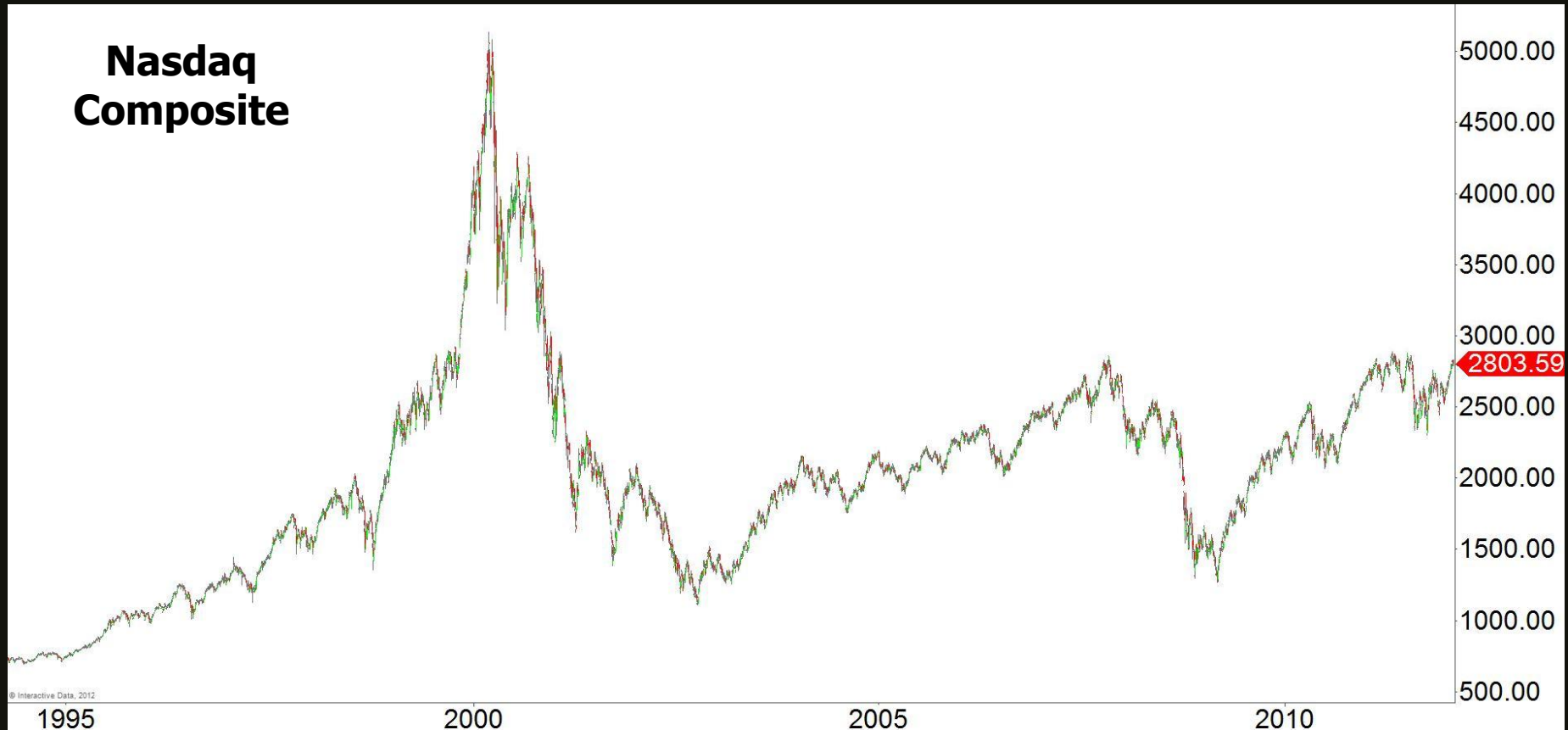
BUYER OR SELLER? CAN YOU ANALYZE PRICE?



PSYCHOLOGICAL PITFALLS INVESTORS FACE



**Nasdaq
Composite**



I knew it all along
(Hindsight Bias)

INVESTING IS EASY IN THE REAR VIEW MIRROR!



- 1) Do you keep a trading journal?**
- 2) Do you remember when you were wrong and how much it cost you?**
- 3) There is a big difference with being a technical analyst and a portfolio manager/trader.**
- 4) You cannot buy yesterday's price.**

AND THIS IS WHY!



PSYCHOLOGICAL PITFALLS INVESTORS FACE



The irrelevant has value as input
(Anchoring)

I BOUGHT IT @ \$70, I'LL SELL IT AT BREAK-EVEN



CAN I SELL IT AND BUY SOMETHING BETTER?



TWTR US Equity (Twitter Inc) Daily 02OCT2013-02OCT2014

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GET RID OF MENTAL BAGGAGE



- 1) The market does not care where you bought your stock.**
- 2) What Cramer says is irrelevant to your position.**
- 3) Do not fall in love with your stocks.**
- 4) Risk management is number 1 key to success.**
- 5) Market is smarter than you are.**

PSYCHOLOGICAL PITFALLS INVESTORS FACE



**I can make a judgement based on what it looks like
(Representativeness Bias)**

TEST



**A bat and a ball together costs \$1.10.
The bat costs \$1.00 more than the
ball. How much does the ball cost?**

PSYCHOLOGICAL PITFALLS INVESTORS FACE



It's not the way I remember it
(Recency Effect)

TEST



Are you bullish or bearish?

This is a trick question.

Buy, sell or hold?

Yes!

Time Frame is Key!

TEST



**You have two options on your
\$10,000 investment:**

- 1) You take a \$1000 profit now.**
- 2) You take a \$1100 profit one
month from now.**

What do you do?

PSYCHOLOGICAL PITFALLS INVESTORS FACE



GOLD



If you tell me it is so, it must be true
(Obstrufication)

PSYCHOLOGICAL PITFALLS INVESTORS FACE



**If you tell me it is so, it must be true
(Obstrufication)**

PSYCHOLOGICAL PITFALLS INVESTORS FACE



- You have recognized a good trade in SU and you are in the money by \$1500.
- Odds are that you will make either \$1950 if the next week's inventory report shows a drawdown and oil prices spike, but you must hold over the week when odds of uncertainty in the Mideast could change the outcome.
- If the rumoured peace accord is reached (announcement is at the same time the inventory report is expected), you only make \$1050 because oil prices will decline.
- You have determined that the odds are 50% for either outcome.
- **Do you hold through the event risk or take your \$1500 profit now: Yes or No?**

A loss isn't a loss until I take it
(Status Quo Bias)

PSYCHOLOGICAL PITFALLS INVESTORS FACE



- Imagine you bought RIM last year because of a potential takeover from an analyst's/brokers recommendation.
- If you sell it now, you are certain to lose \$750, but if you hang on over the weekend, the rumour is that a deal will be announced Monday and you might only lose \$525.
- But if no deal is announced, it will probably tank Monday and you will be down \$975.
- The options market suggests the odds of a deal Monday is about 50%.
- **Would you take the guaranteed loss today or hold until Monday in hopes to recover some loss?**

A loss isn't a loss until I take it
(Status Quo Bias)

THE STATUS QUO UNTIL... THE PAIN IS TOO HIGH



ACWI US Equity (iShares MSCI ACWI ETF) Daily 20SEP2009-19SEP2014

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SOLUTIONS



Self Awareness

Positive Psychology

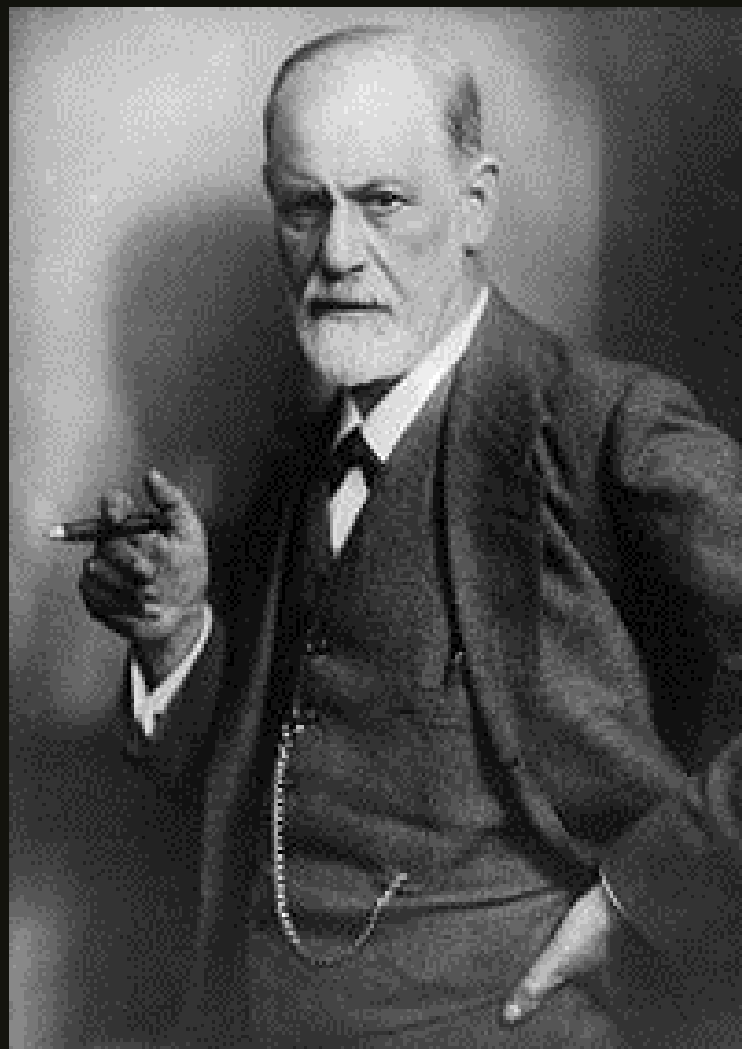
Keep A Trading “Why” Journal

Make The Next Decision A Better One

Check Your Ego At The Door

None of These Are Technical, But Can Be
Material Success Factors

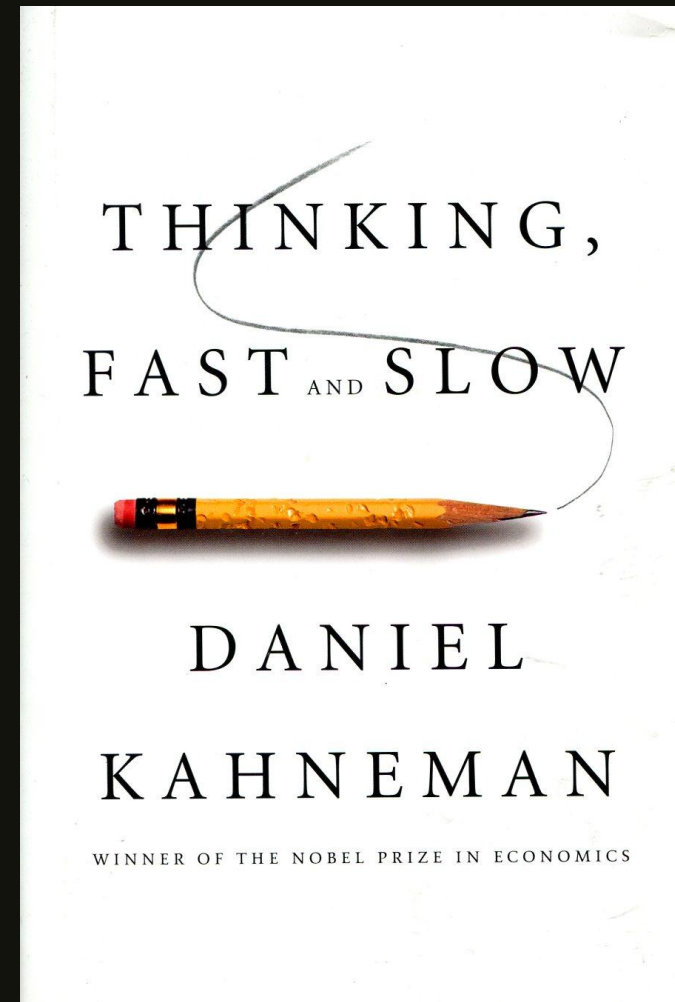
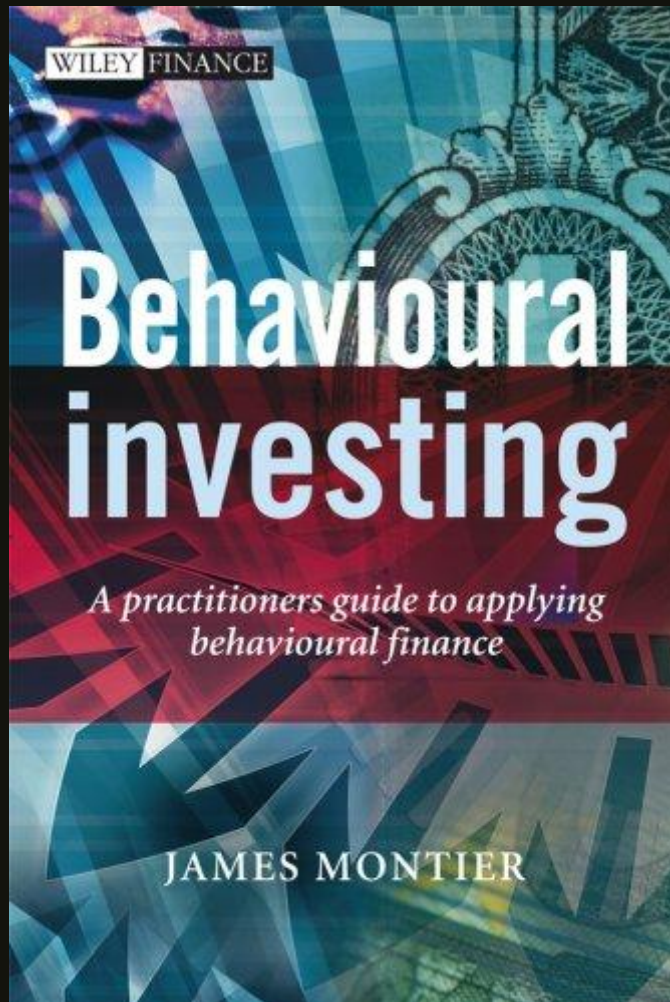
UNDERSTANDING WHO YOU ARE AS AN INVESTOR



**How you think
about investing
is directly
related to your
outcome.**

**The Market is
smarter than You!**

LEARN MORE



Positive Priming

You Can Do It!

Doing your own investing can be as simple as having the right framework for making decisions, keeping your cool when markets fluctuate, and sticking to a program of proper diversification and risk management.

Now, think about your most important retirement goal, and how great it would feel to achieve that!

Then, answer 6 simple questions on the back...



Negative Priming

Frustrated?

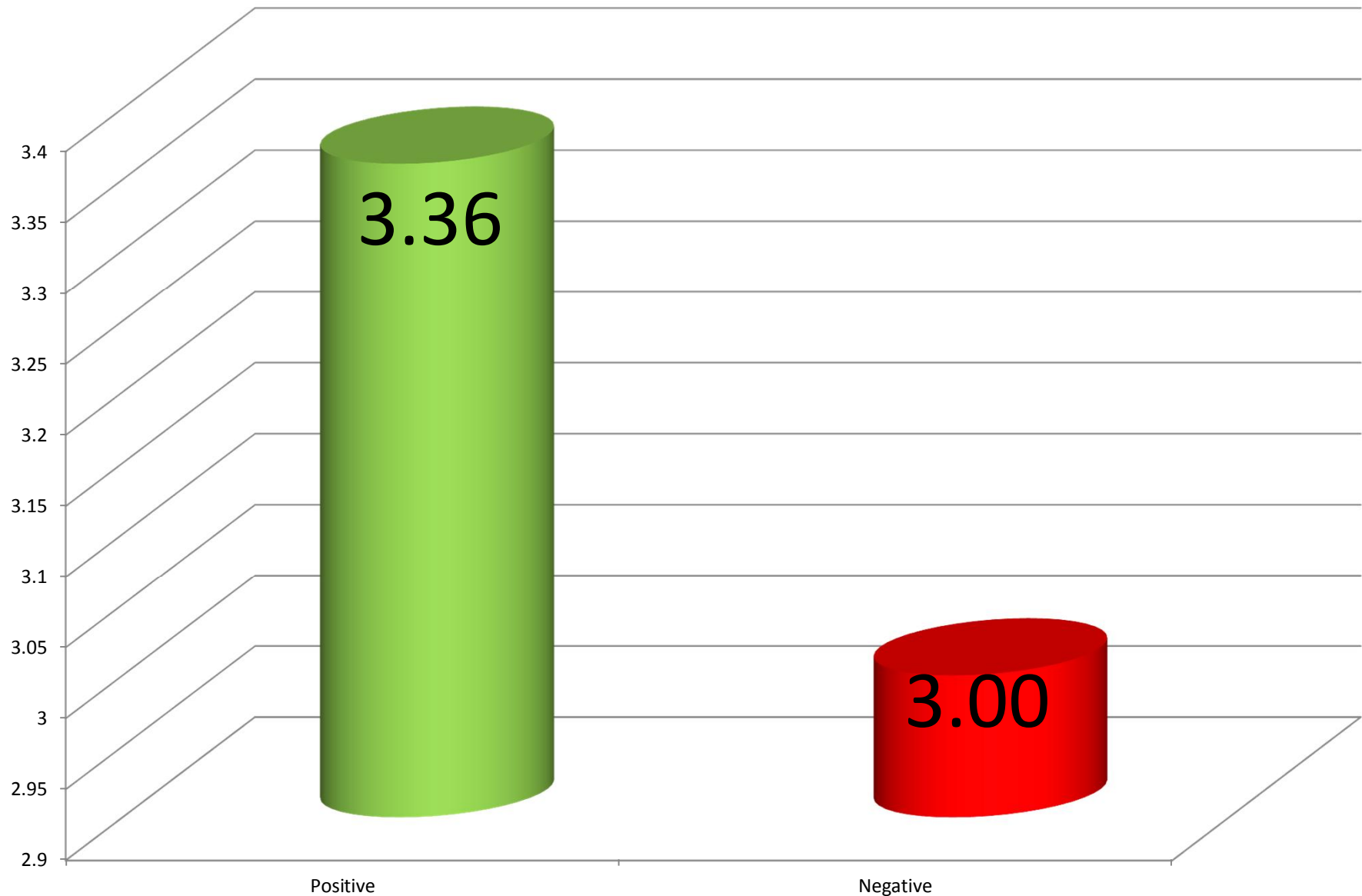
Doing your own investing can be challenging. That's why having the right framework for making decisions, keeping your cool when markets fluctuate, and sticking to a program of proper diversification and risk management are absolutely essential to not losing your hard earned retirement savings!

Now, think about the worst investment decision you've ever made and how it could be avoided.

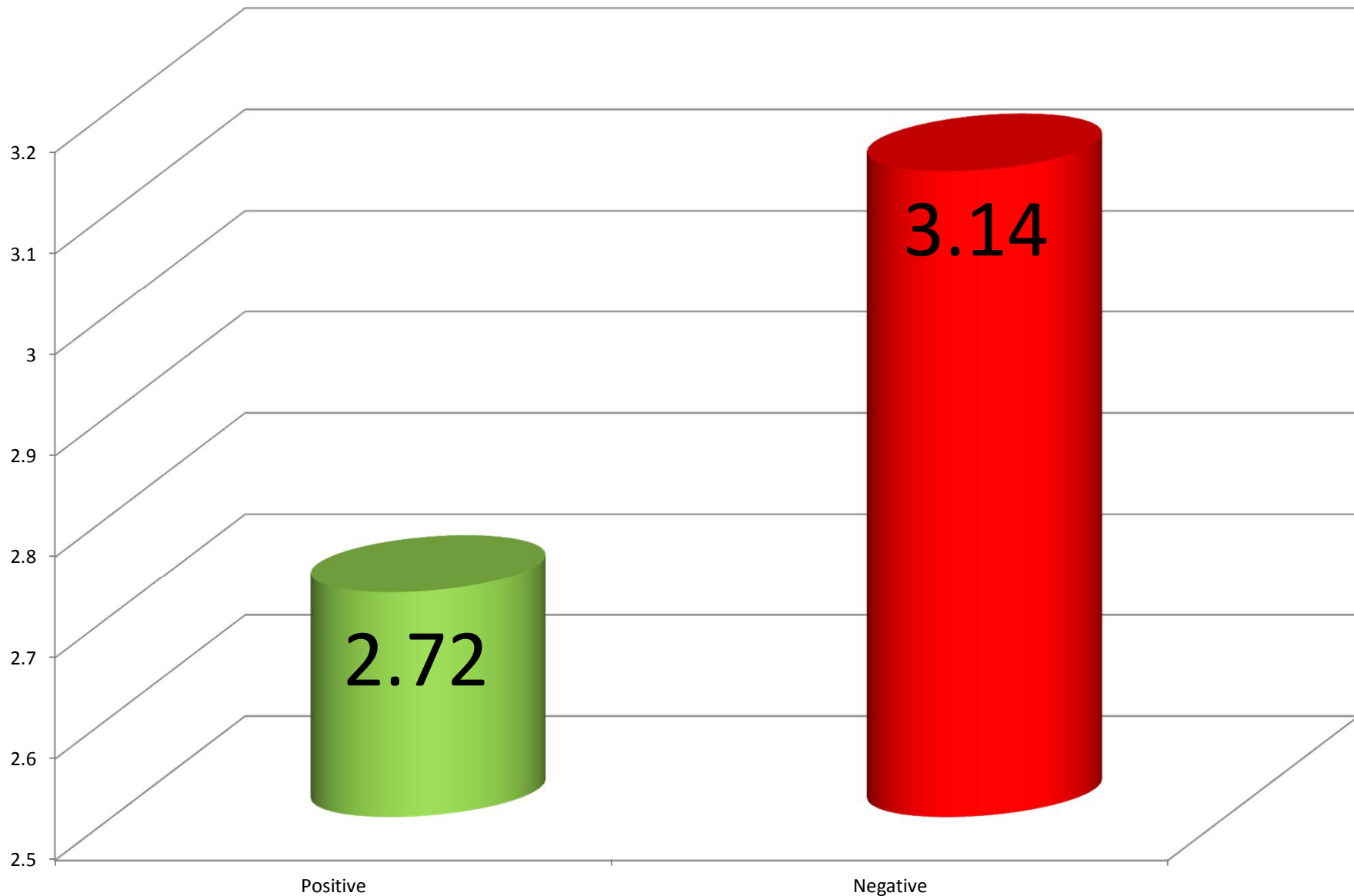
Then, answer 6 simple questions on the back...



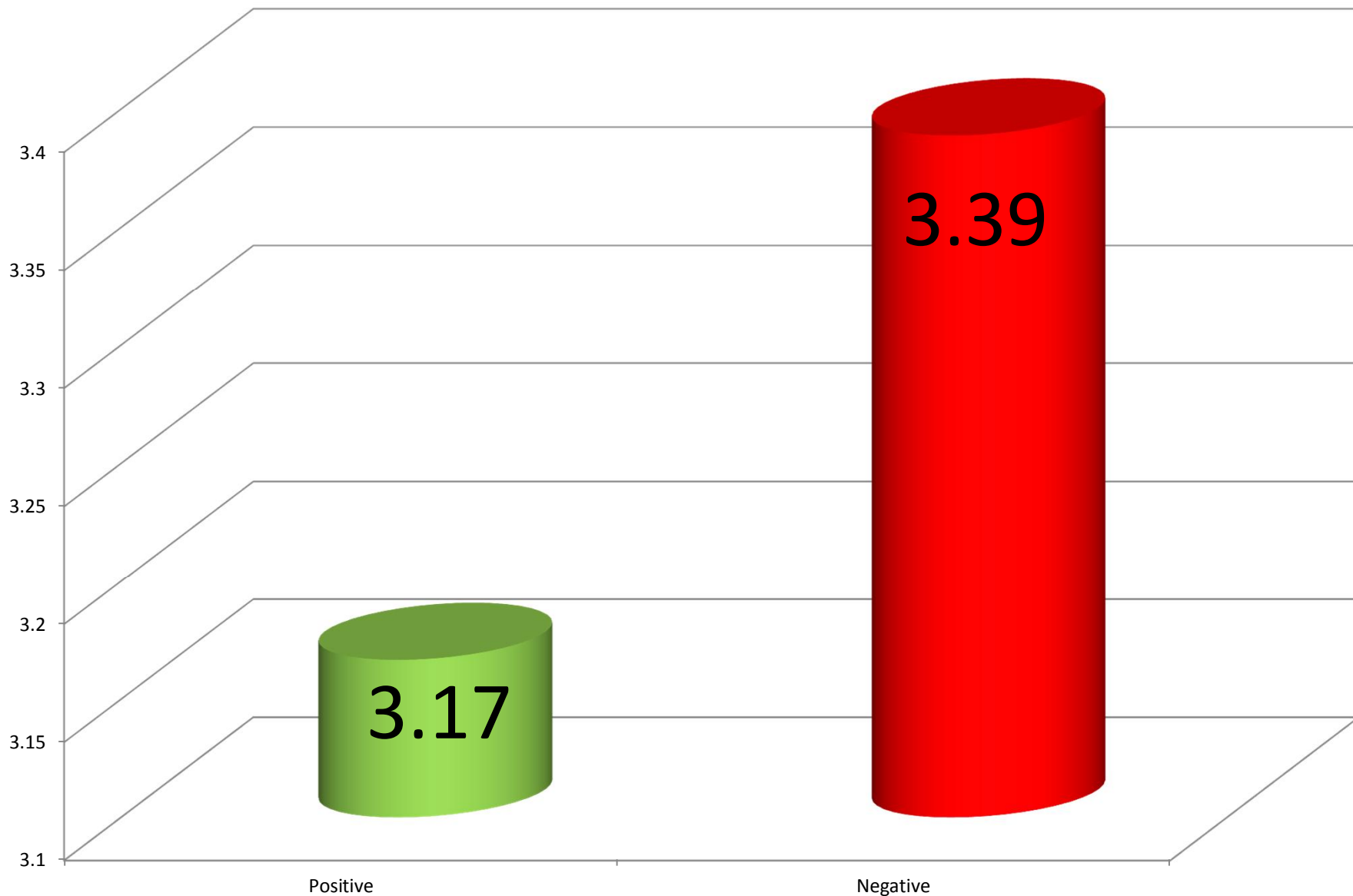
I mostly consider myself to a be a buy and hold investor



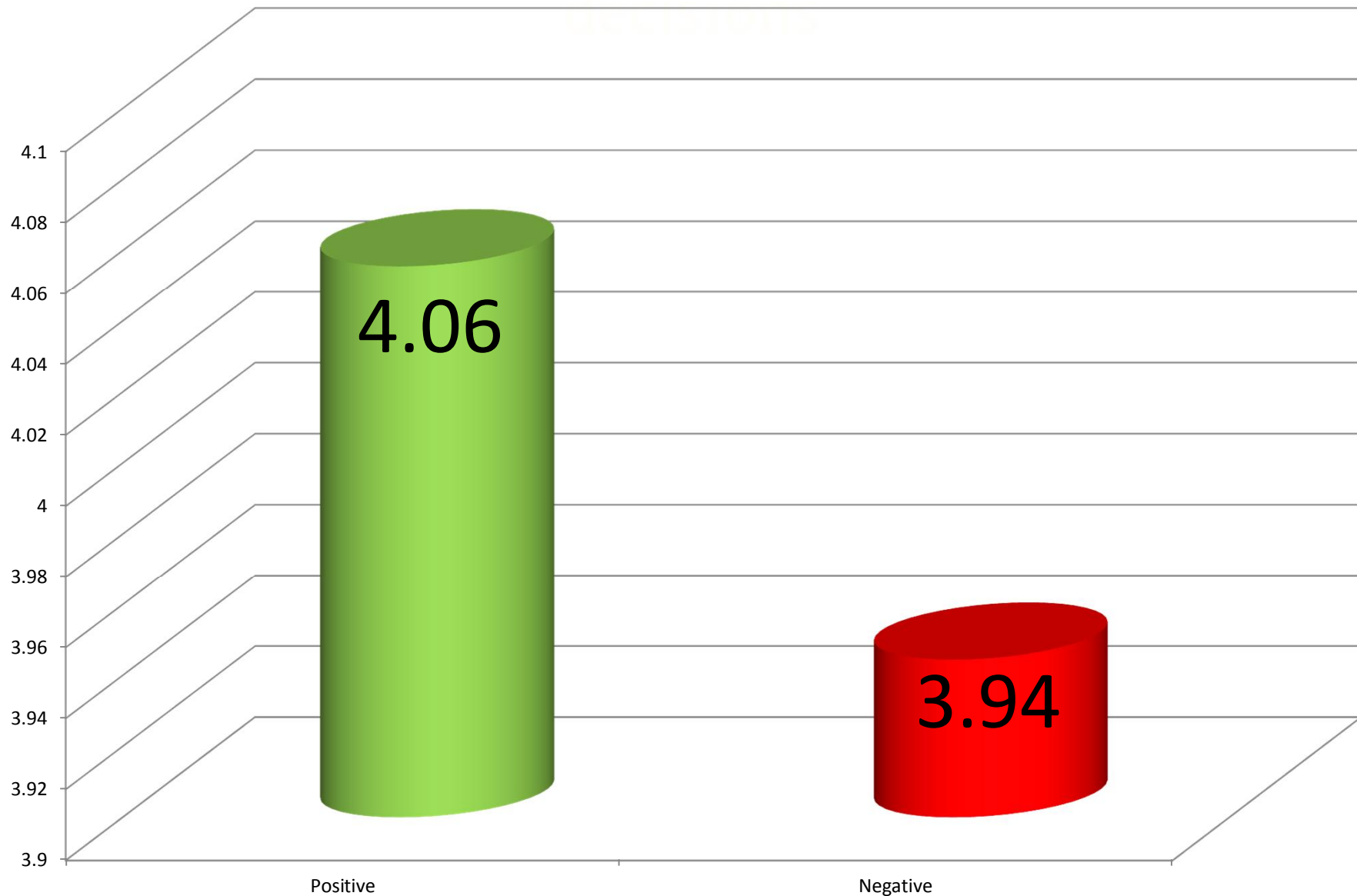
I prefer short-term or swing trading to long-term investments



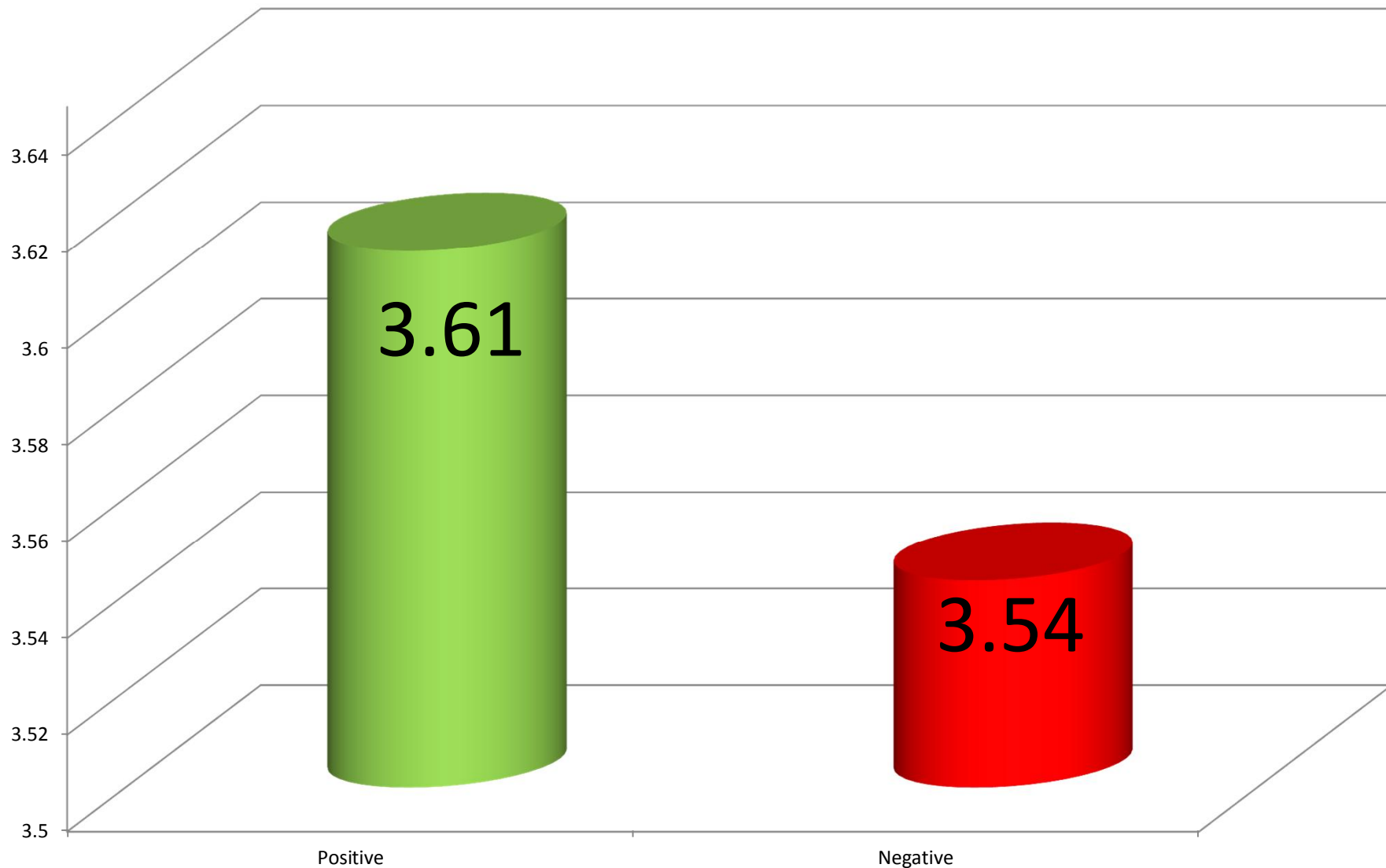
I am perfectly comfortable making my own investment decisions



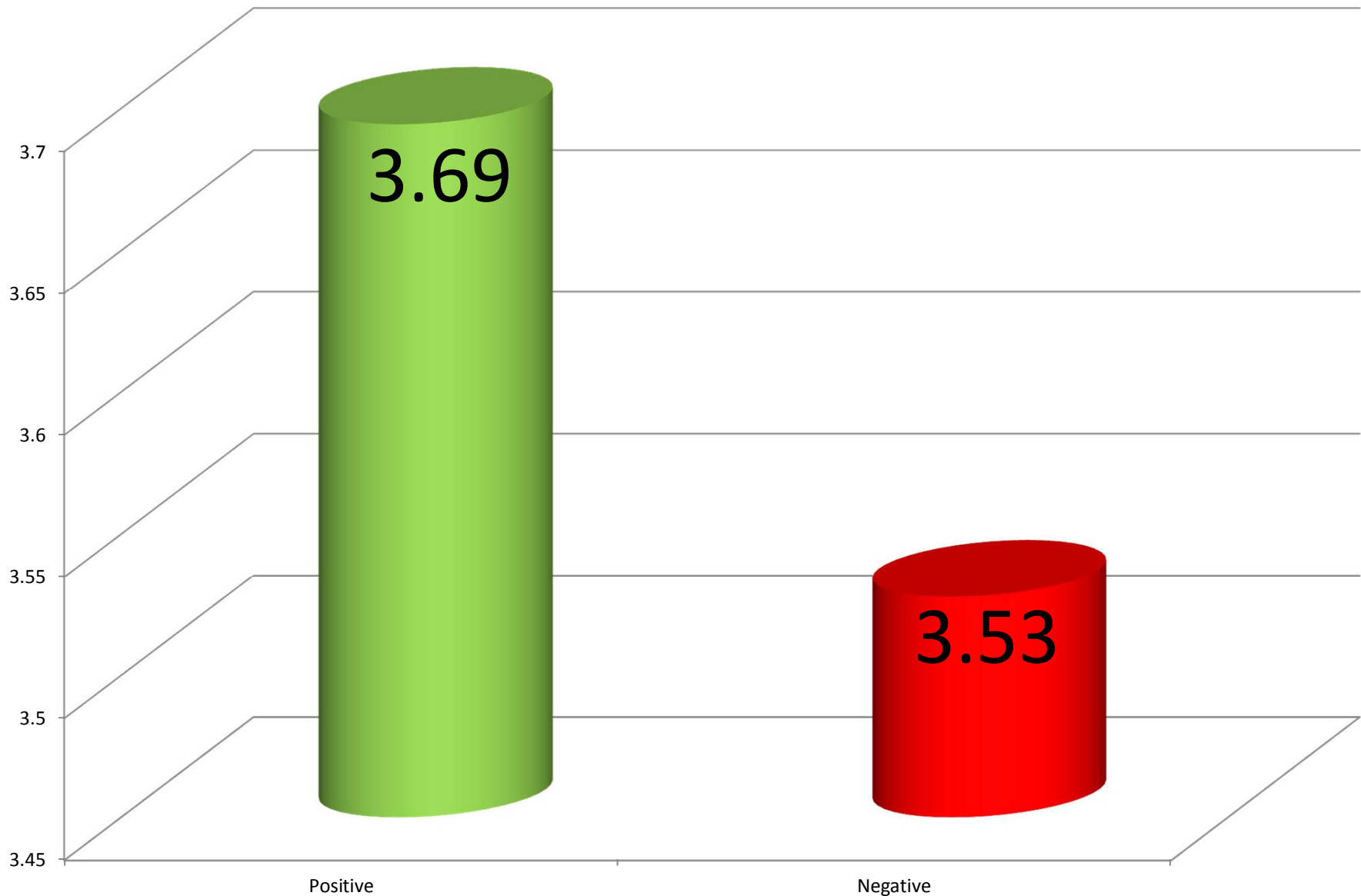
I would prefer having a little guidance vs. being completely on my own to make all investment



I am highly confident that I will reach my retirement goals



My life is getting better with each passing year



**CHOOSE A NUMBER BETWEEN 0
AND 100 SUCH THAT**



**The winner of this contest is the
person who comes closest to
guessing the number that is
2/3rds the average of all guesses
in the room.**