



# Managing the Monkey

Avoiding self-defeating investing habits



## **Ed Croft**

Co-Founder [Stockopedia.com](https://stockopedia.com)

Ex-stock broker, code geek &  
highly motivated private investor!

# Agenda

- Why do we make so many mistakes?
- Understanding the mind...
  - Overconfidence
  - Attention
  - Narrative & Authority
  - Loss aversion
  - Anchoring
- How you can manage your monkey !
- Stock Picks

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We would like to draw your attention to the following important investment warnings:

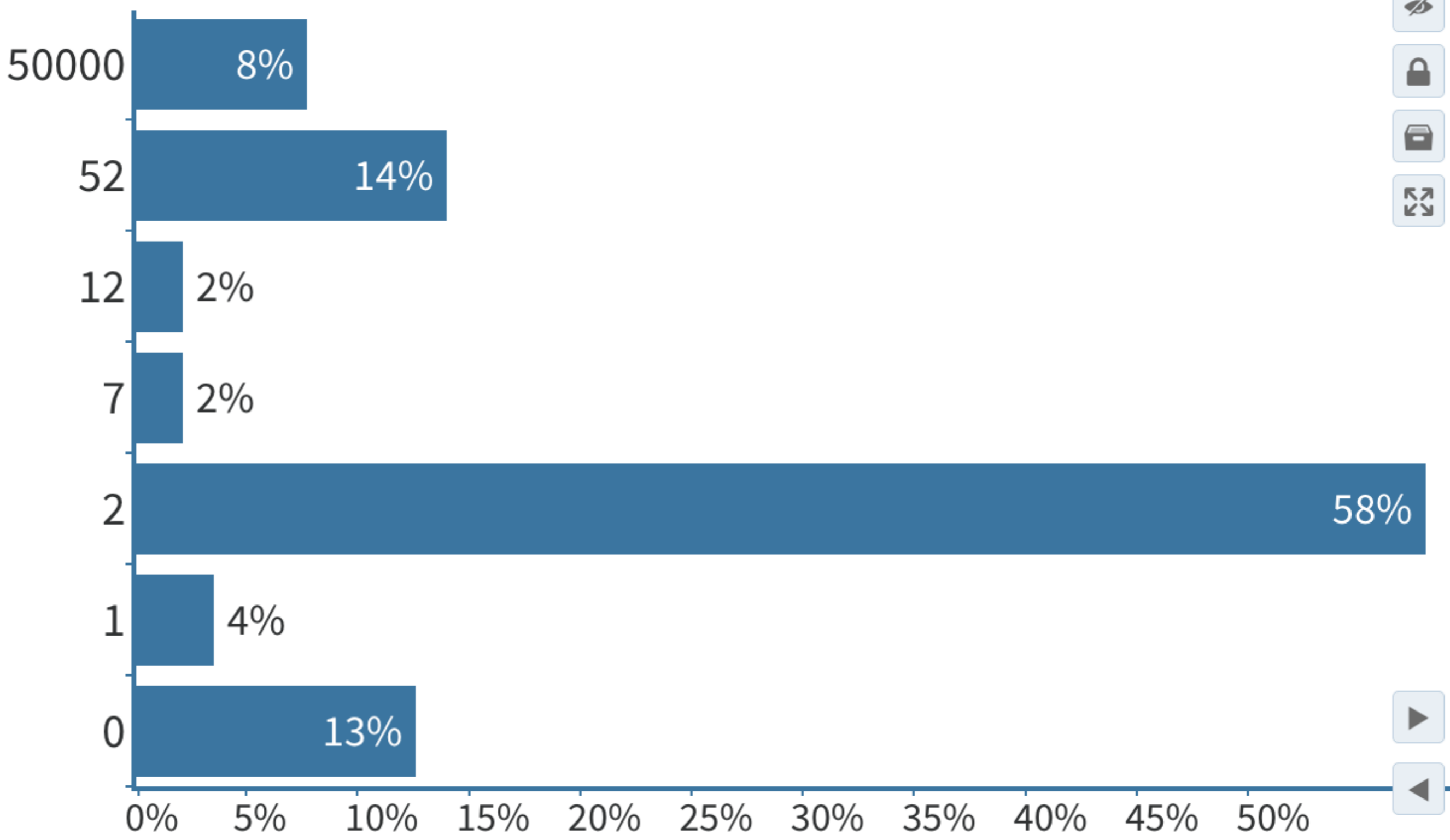
- The value of shares and investments and the income derived from them can go down as well as up
- Investors may not get back the amount they invested
- Past performance is not a guide to future performance

Please note that all data in this document is historic and dated when this document went to print: 26th April 2016



# How many animals of each kind did Moses take on the Ark?

Respond at [PollEv.com/stocko](https://PollEv.com/stocko)

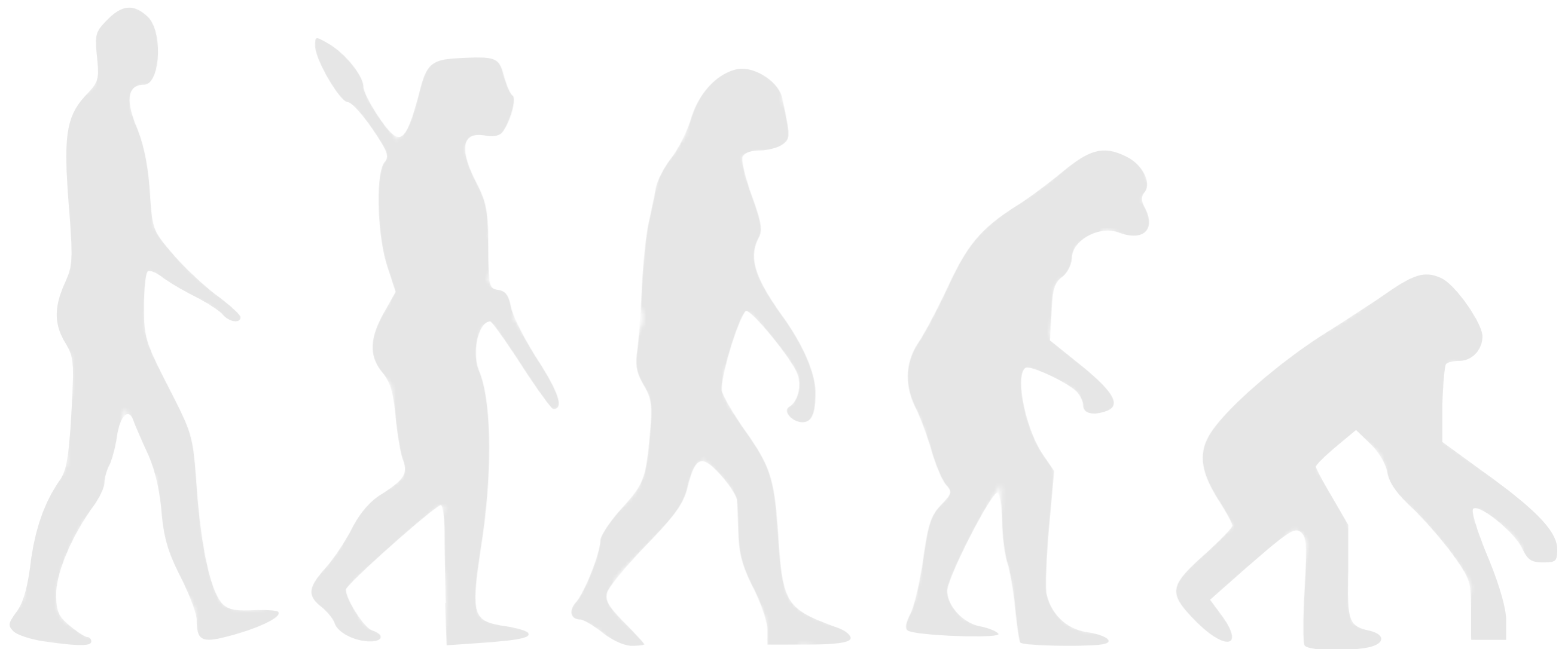


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Why do private  
investors  
make so many  
**mistakes?**

“The investor’s chief problem  
and even his **worst enemy** - is  
likely to be himself” **Ben Graham**





# African Potash

**AFPO**  0.621p ▼ -0.1 -11.3% 3:38pm 150k

Market Cap £5.78m  
Enterprise Value £7.28m  
Revenue £40.7k  
Position in Universe 1554th / 1809

Value ▲ 30  
Quality 9  
Momentum ▼ 10  
**StockRank™** 5

## African Potash

Apr 27, 2016 - Daily

(c) Stockopedia 2016



# Snoozebox Holdings

**ZZZ**  0.424p ▼ -0.0 -3.6% 3:29pm 15.0k

Market Cap £1.30m  
Enterprise Value £360k  
Revenue £4.38m  
Position in Universe 1737th / 1809

Value ▲ 78  
Quality 5  
Momentum ▼ 4  
**StockRank™** ▲ **18**

## Snoozebox Holdings

Apr 27, 2016 - Daily

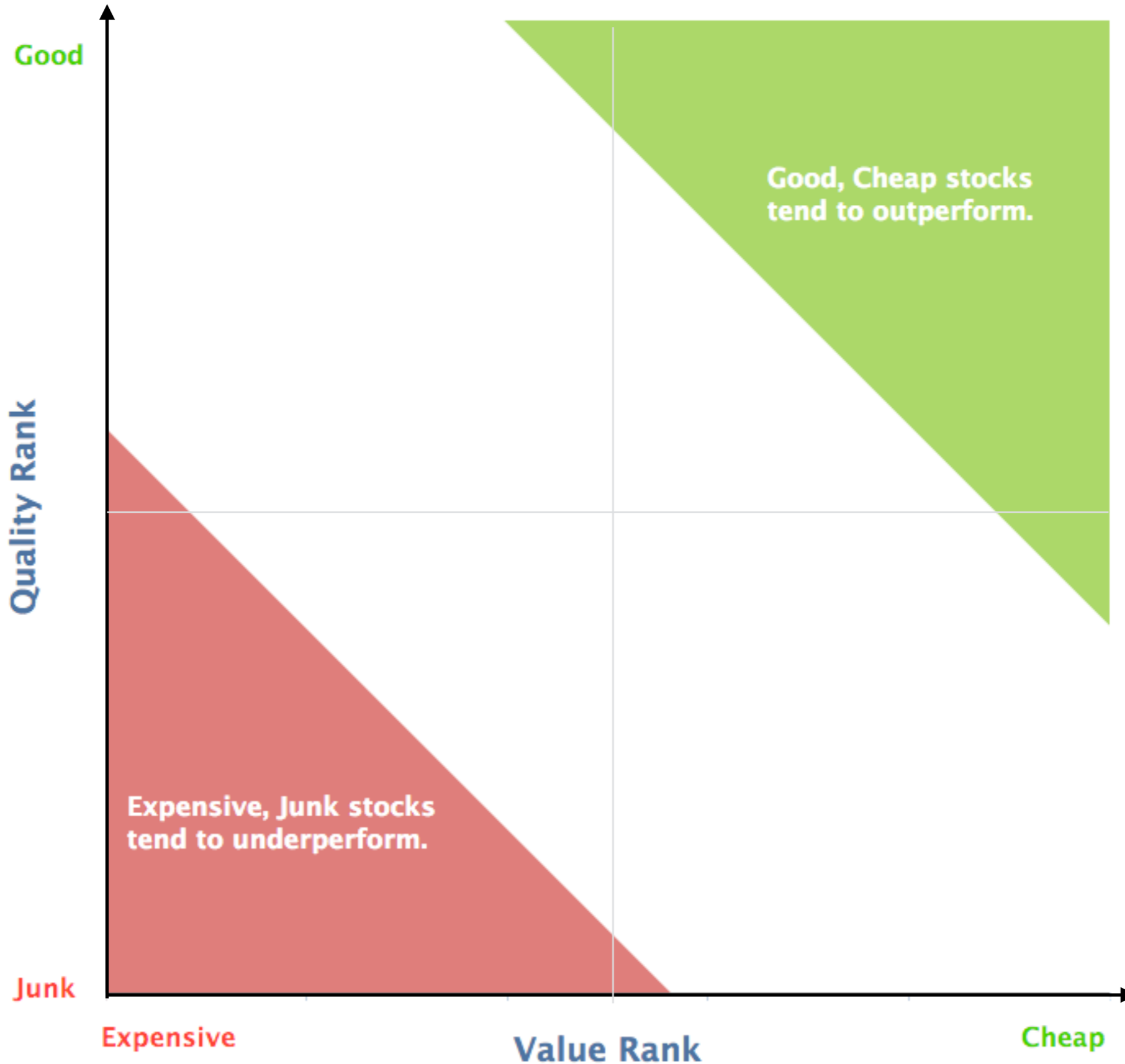
(c) Stockopedia 2016



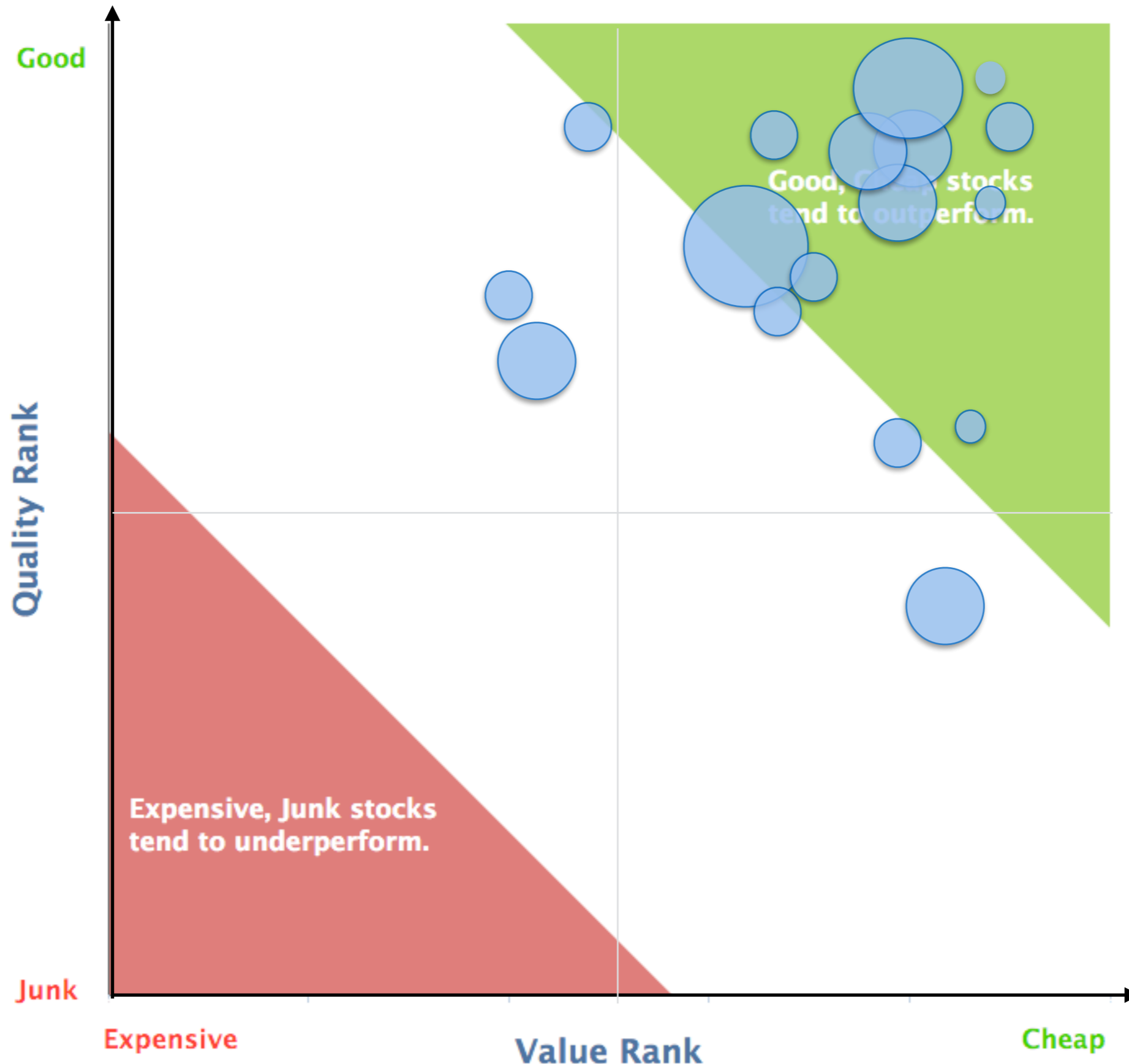
# Quality vs Value



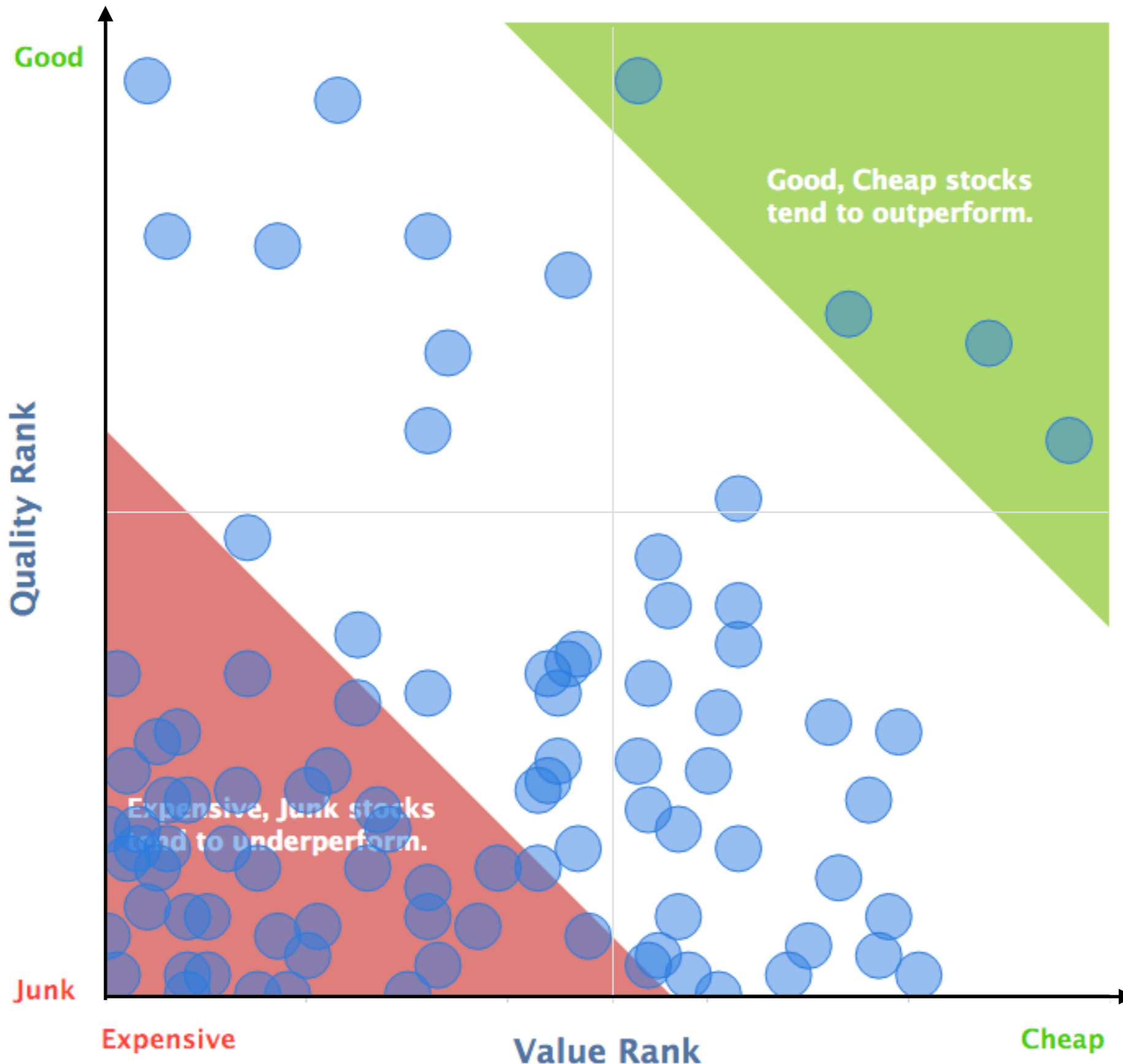
# Quality vs Value



# Stocks from a great investor

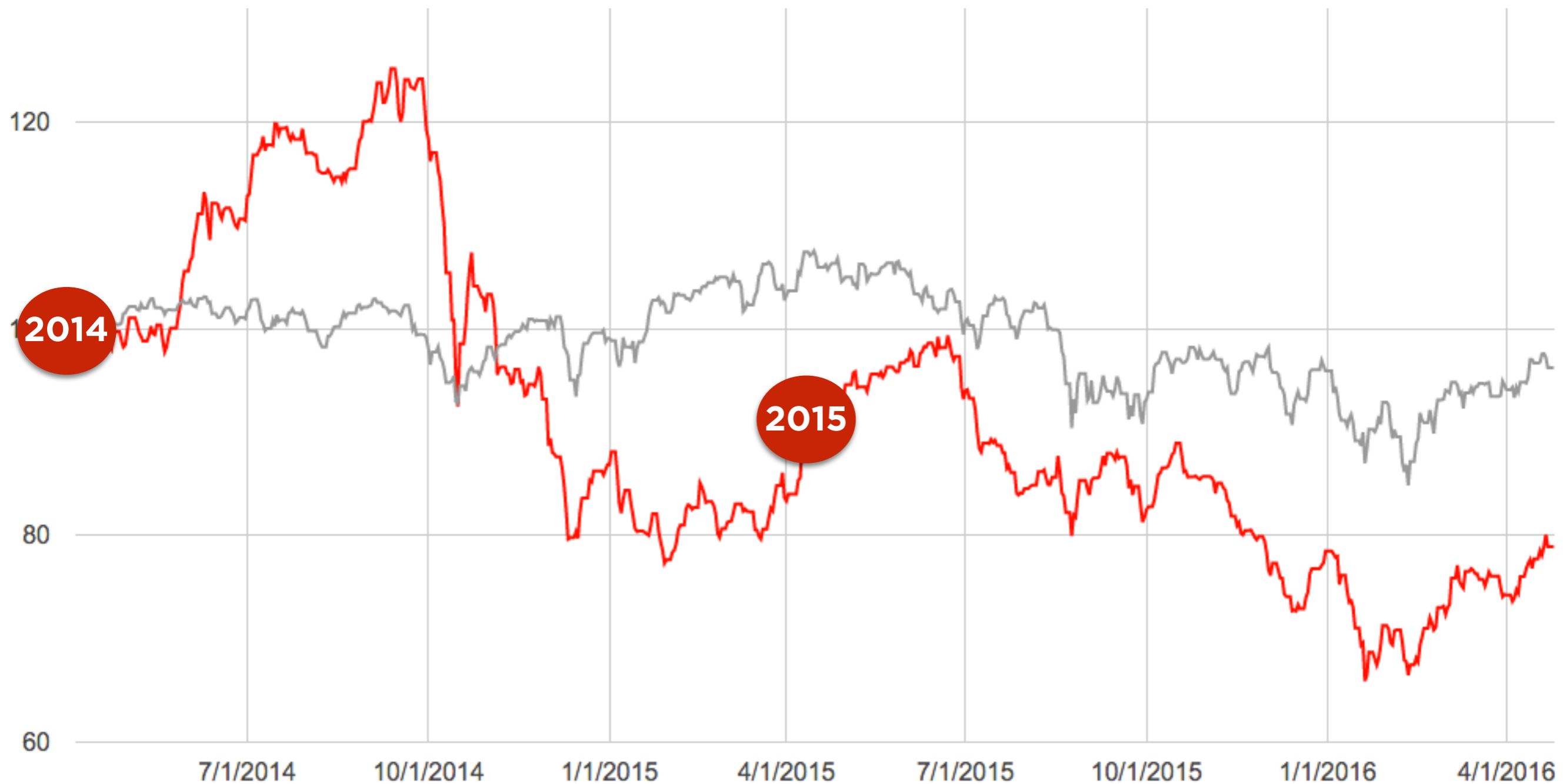


# Most discussed UK stocks



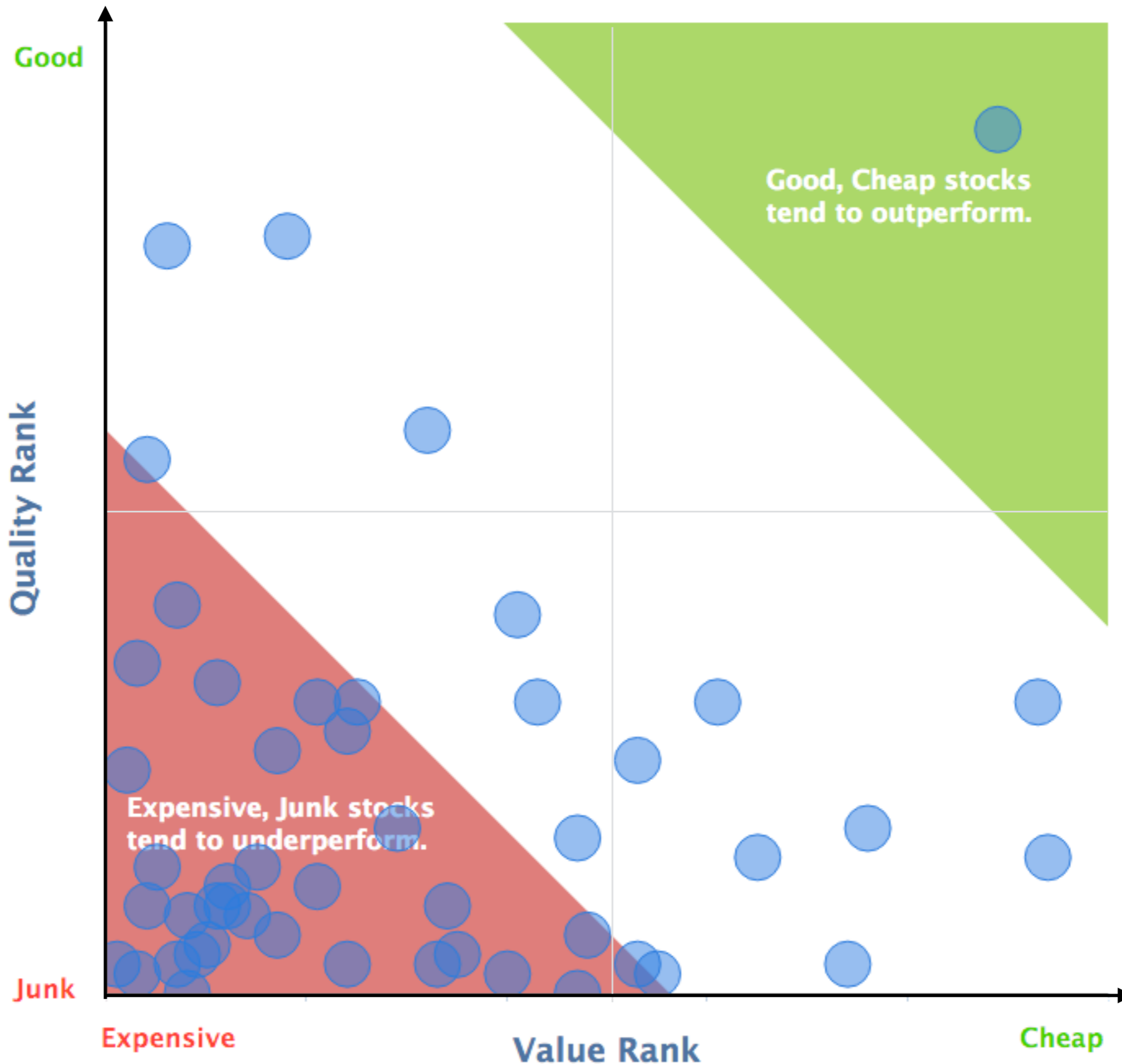
# Returns to UK's "most discussed" stocks

**Most discussed -22% vs FTSE All Share -3.6%**



\*Performance of 100 most discussed stocks rebalanced annually.

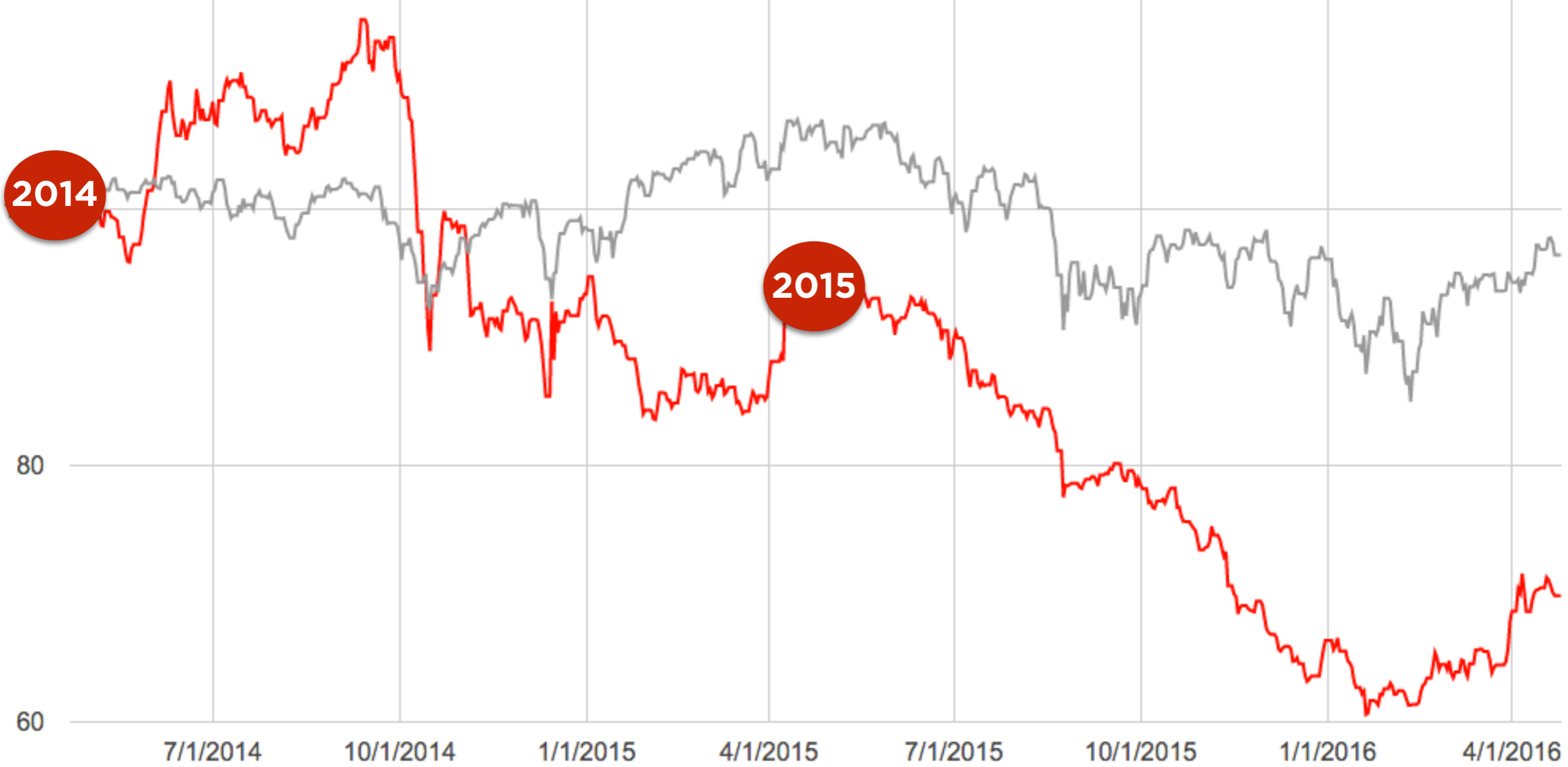
# UKIS Exhibitors 2016





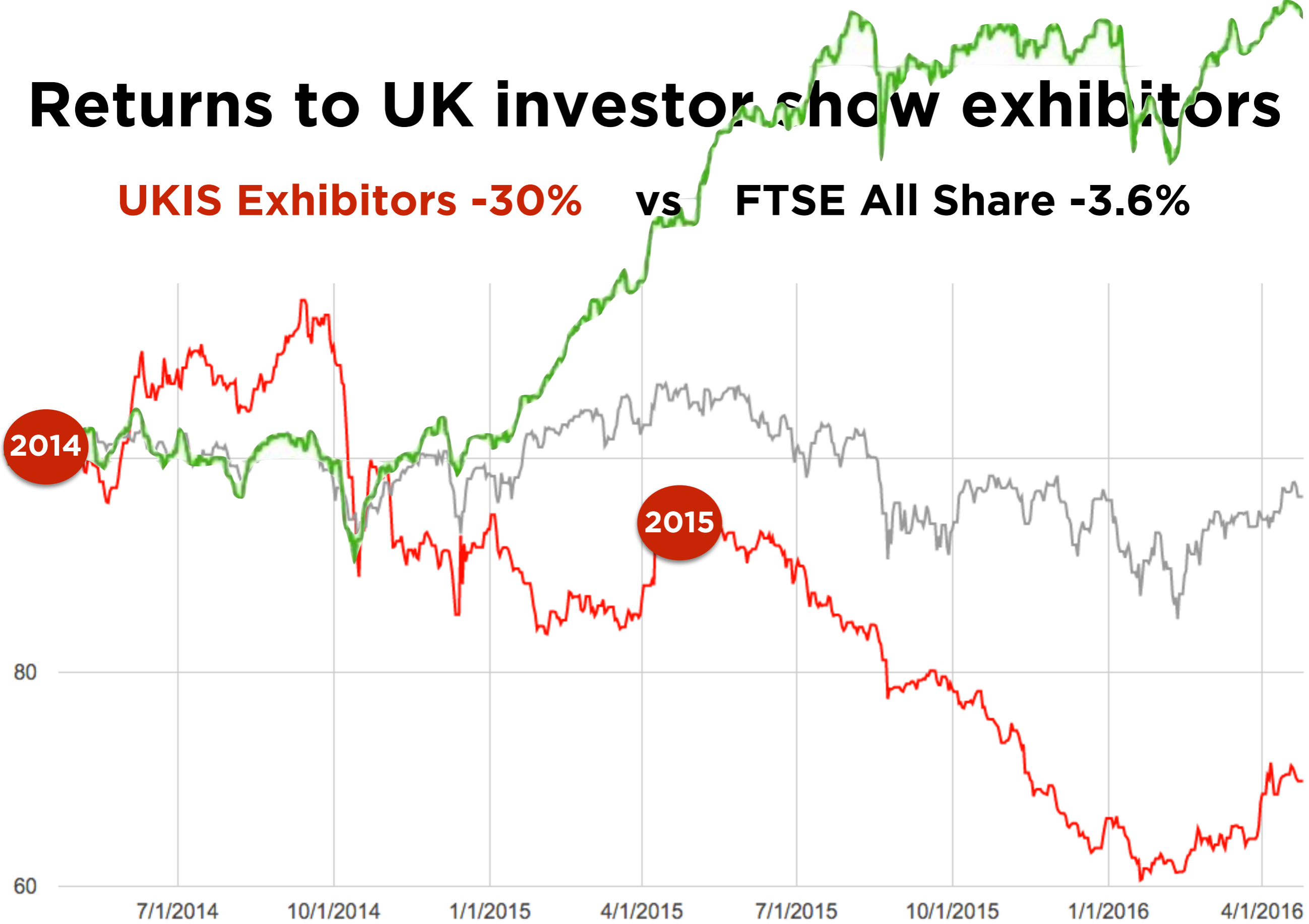
# Returns to UK investor show exhibitors

**UKIS Exhibitors -30%** vs **FTSE All Share -3.6%**



# Returns to UK investor show exhibitors

**UKIS Exhibitors -30%** vs **FTSE All Share -3.6%**



# The average private investor\*

- Only owns **4 stocks**
- Concentrated in a **single sector**
- Trades over **75%** of portfolio annually

\* Barber & Odean - **Trading is hazardous to your wealth** - 2000

If you want to have a better performance than the crowd, you must do things differently from the crowd.

**Sir John Templeton**

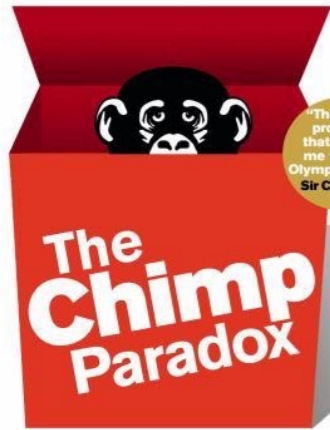


# Understanding the **human mind**

# 3 Questions



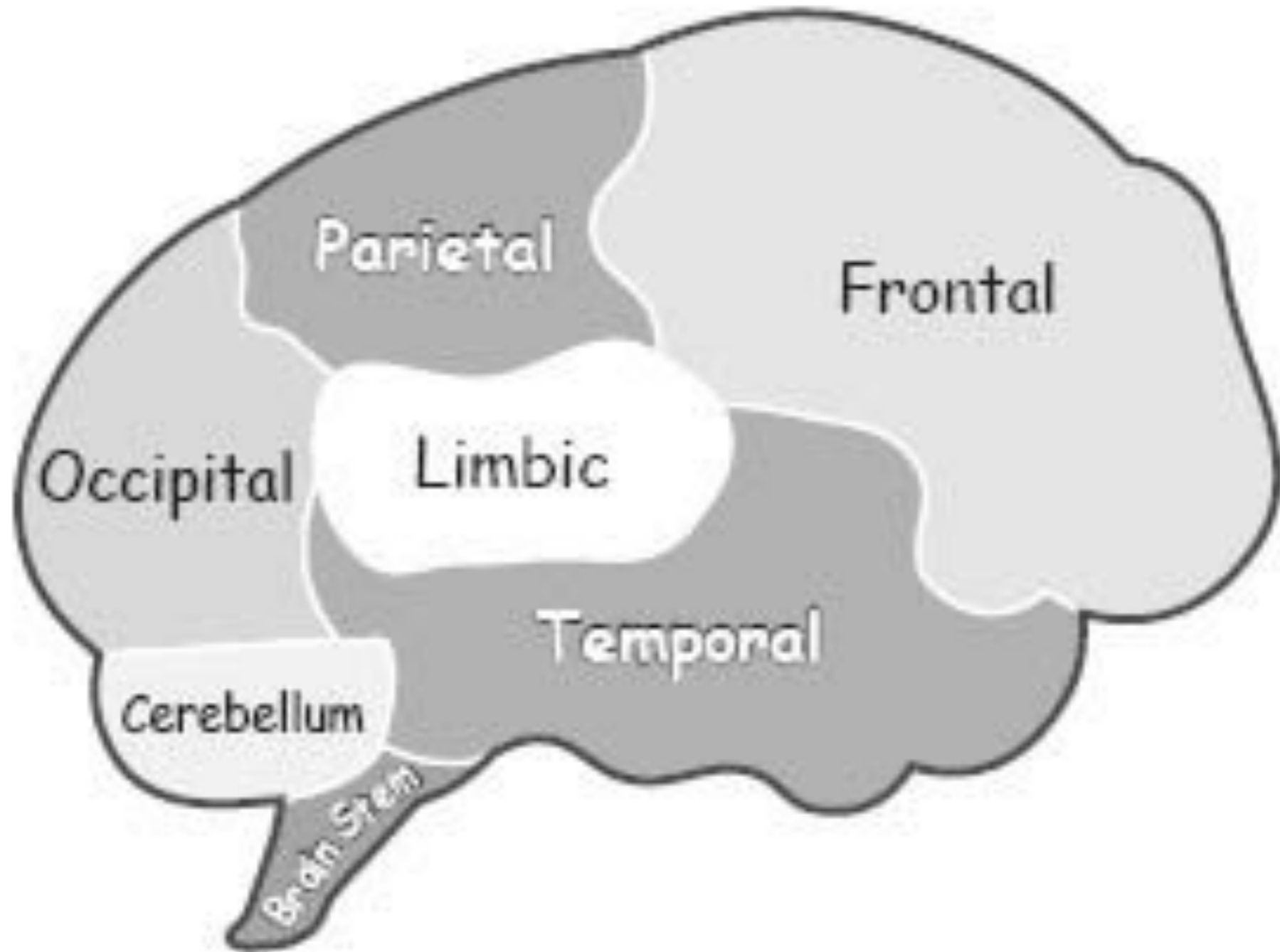
**Poll**



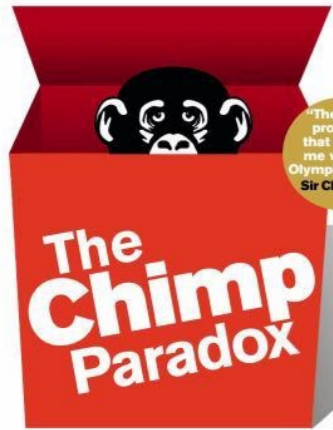
"The mind program that helped me win my Olympic Golds"  
Sir Chris Hoy

The  
**Mind Management Program**  
to Help You Achieve Success,  
Confidence, and Happiness

**Dr Steve Peters**





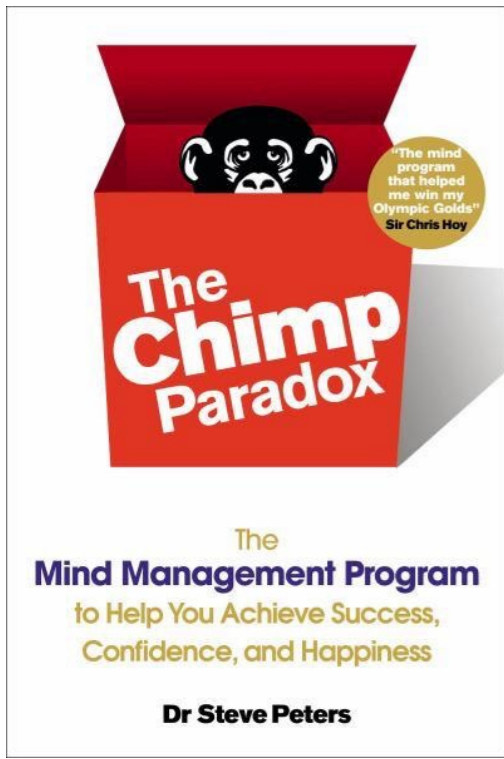


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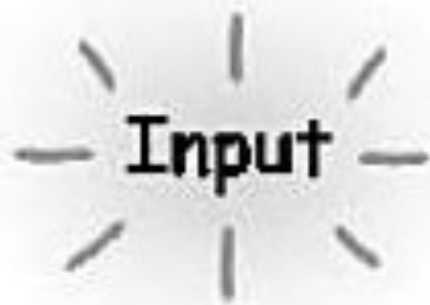
The  
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## Process



Chimp first



Human second

**System 1**

**System 2**

# System 1

**Fast**

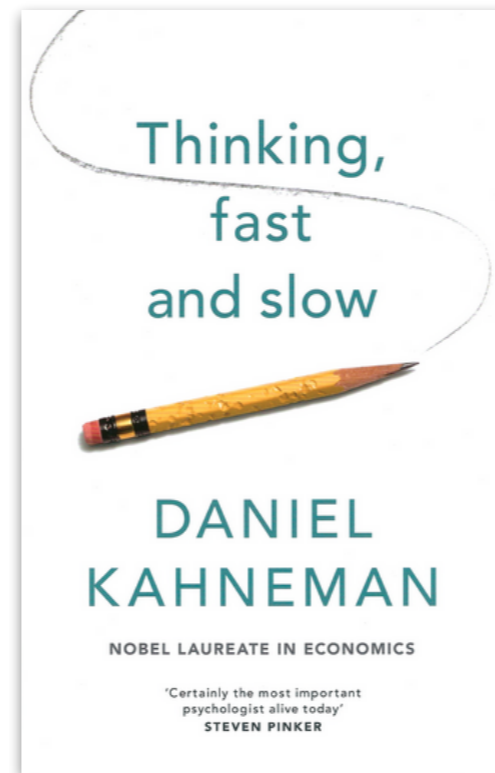
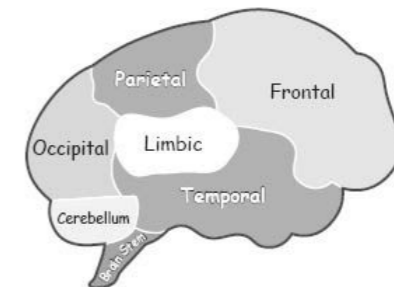
Automatic  
Intuitive  
Emotional  
Active



# System 2

**Slow**

Considered  
Logical  
Effortful  
Lazy



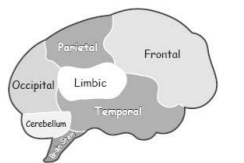
# Cognitive Reflection Test

It assesses an individuals' ability to ....

suppress an **intuitive wrong answer**

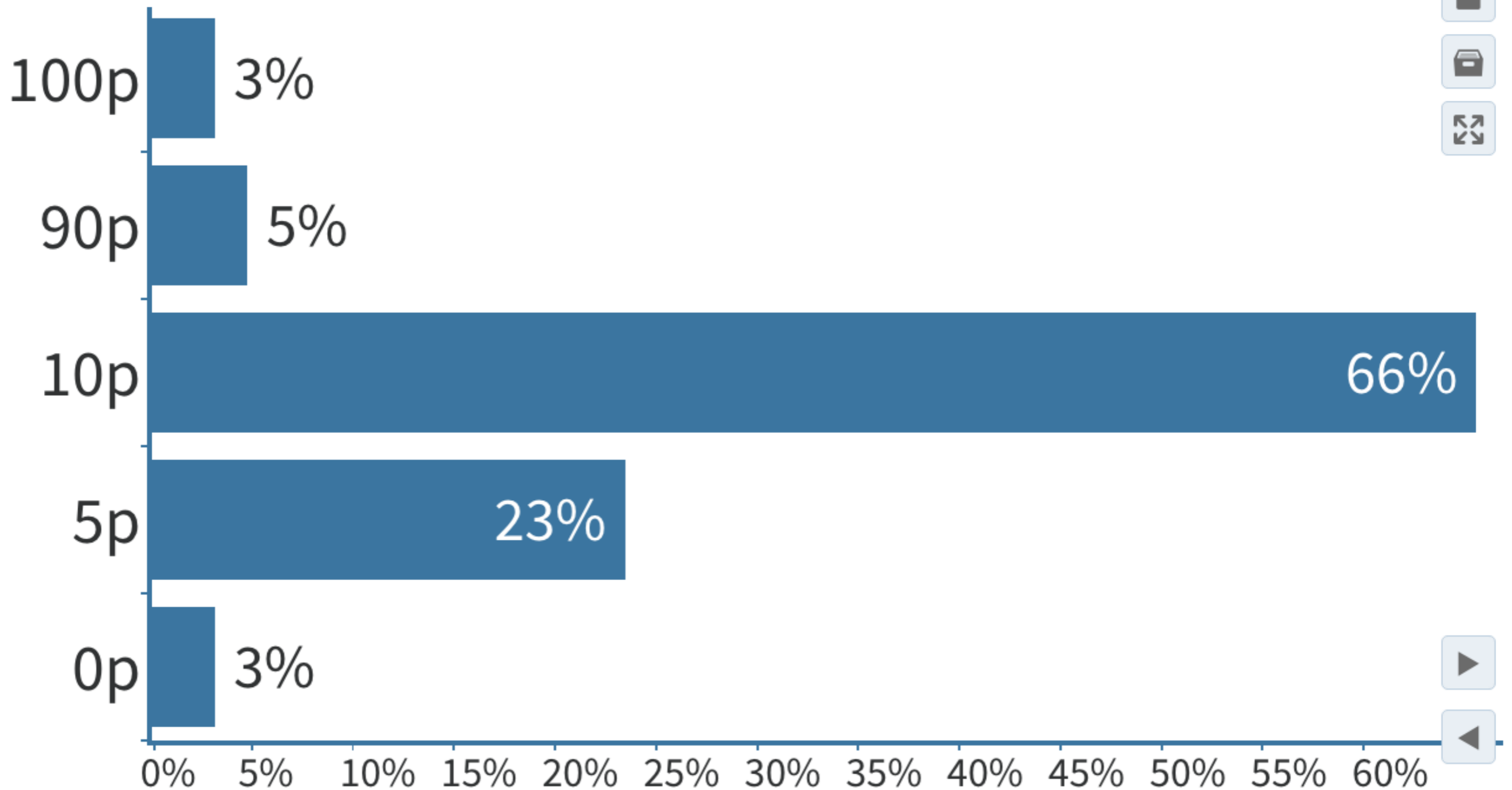


in favour of an **effortful right answer**



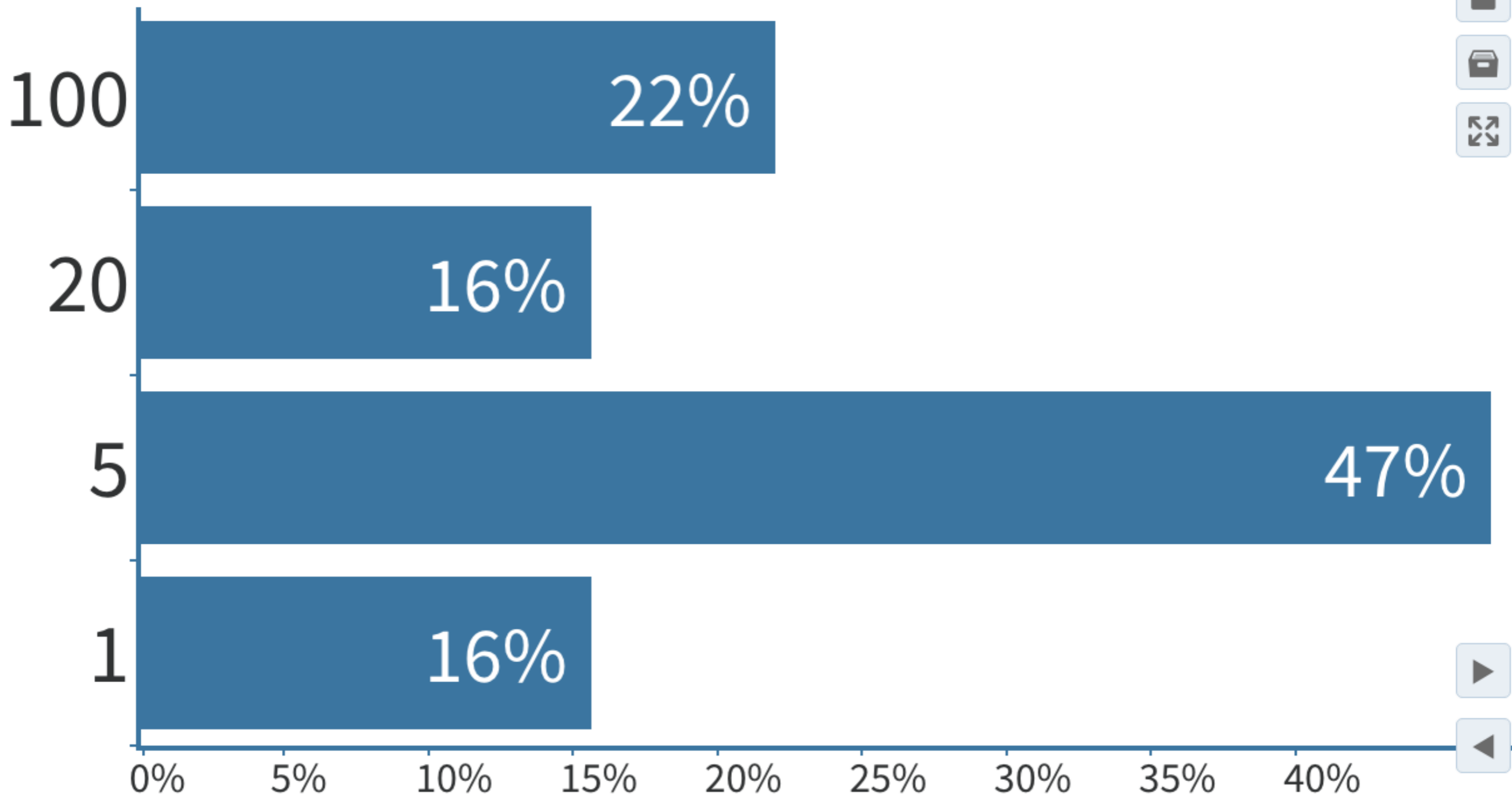
A bat and a ball cost £1.10 in total. The bat costs £1.00 more than the ball. How much does the ball cost?

When poll is active, respond at [Pollev.com/stocko](https://Pollev.com/stocko)



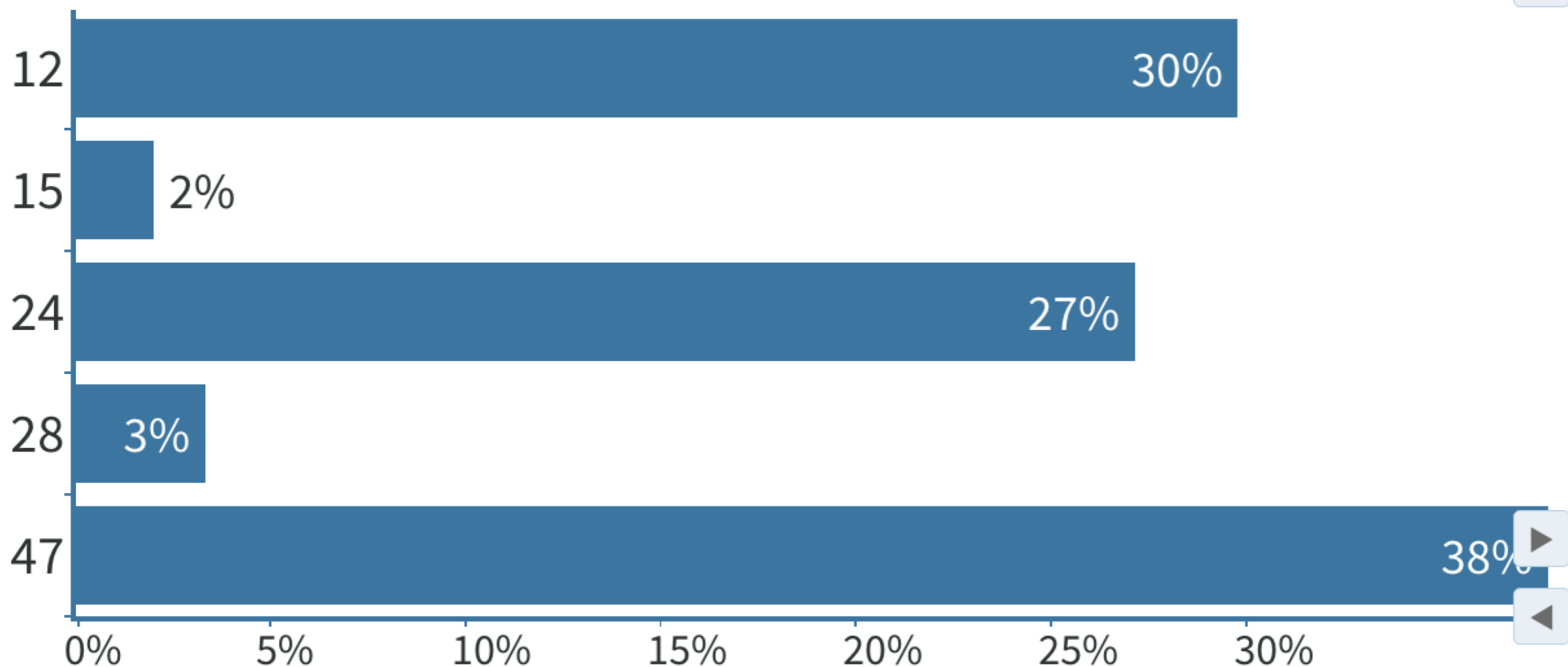
If it takes 5 machines 5 minutes to make 5 widgets, how long would it take 100 machines to make 100 widgets?

When poll is active, respond at [PollEv.com/stocko](https://PollEv.com/stocko)

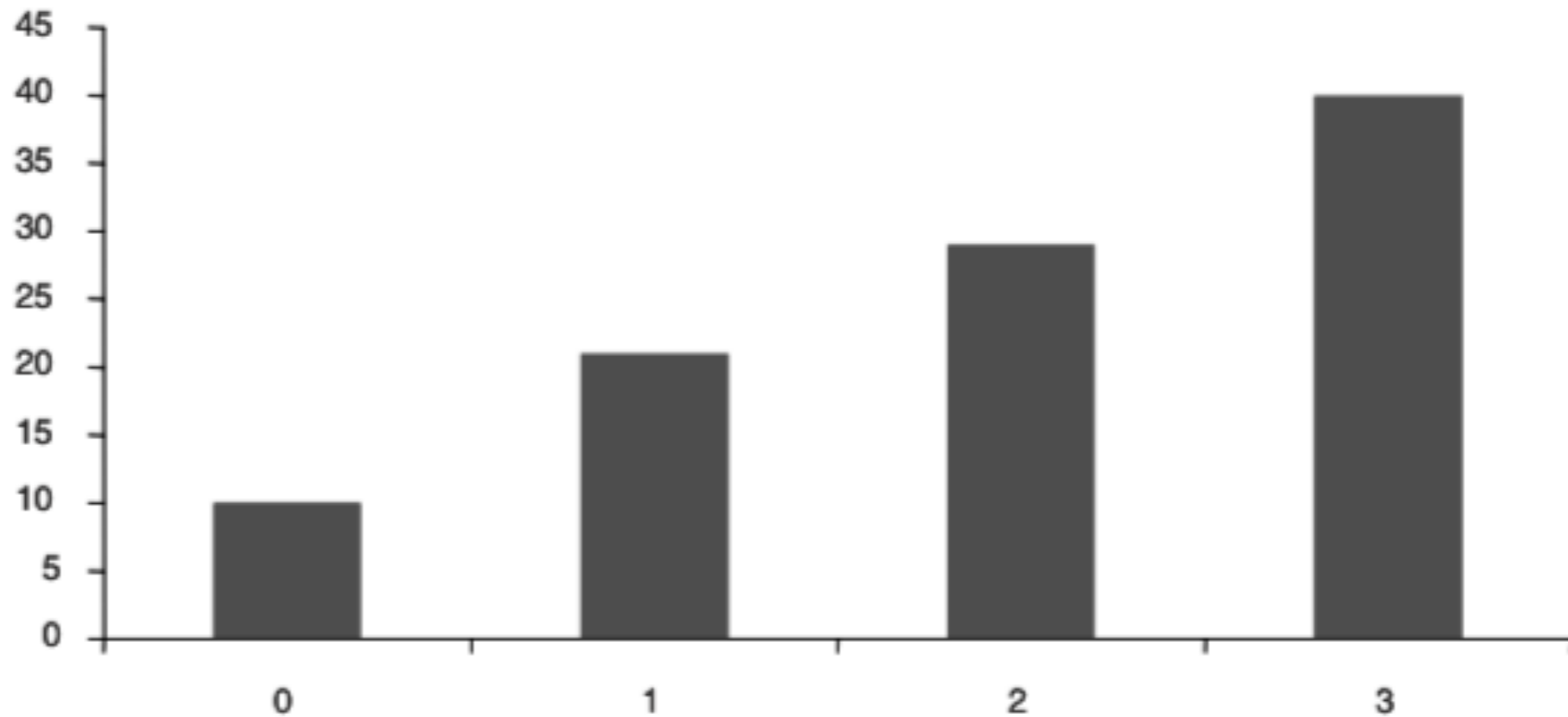


In a lake, there is a patch of lily pads. Every day, the patch doubles in size. If it takes 48 days for the patch to cover the entire lake, how long would it take for the patch to cover half of the lake?

When poll is active, respond at [Pollev.com/stocko](https://Pollev.com/stocko)



# Fund Manager CRT Results



**Figure 13.3** Percentage of CRT questions correctly answered  
*Source:* SG Equity research.





# Key Takeaway

- Under pressure system-1 (the chimp) dominates.
- The chimp is not designed for investing & will sabotage your folio.
- Even with a dominant system-2, the chimp gets cocky & overconfident.

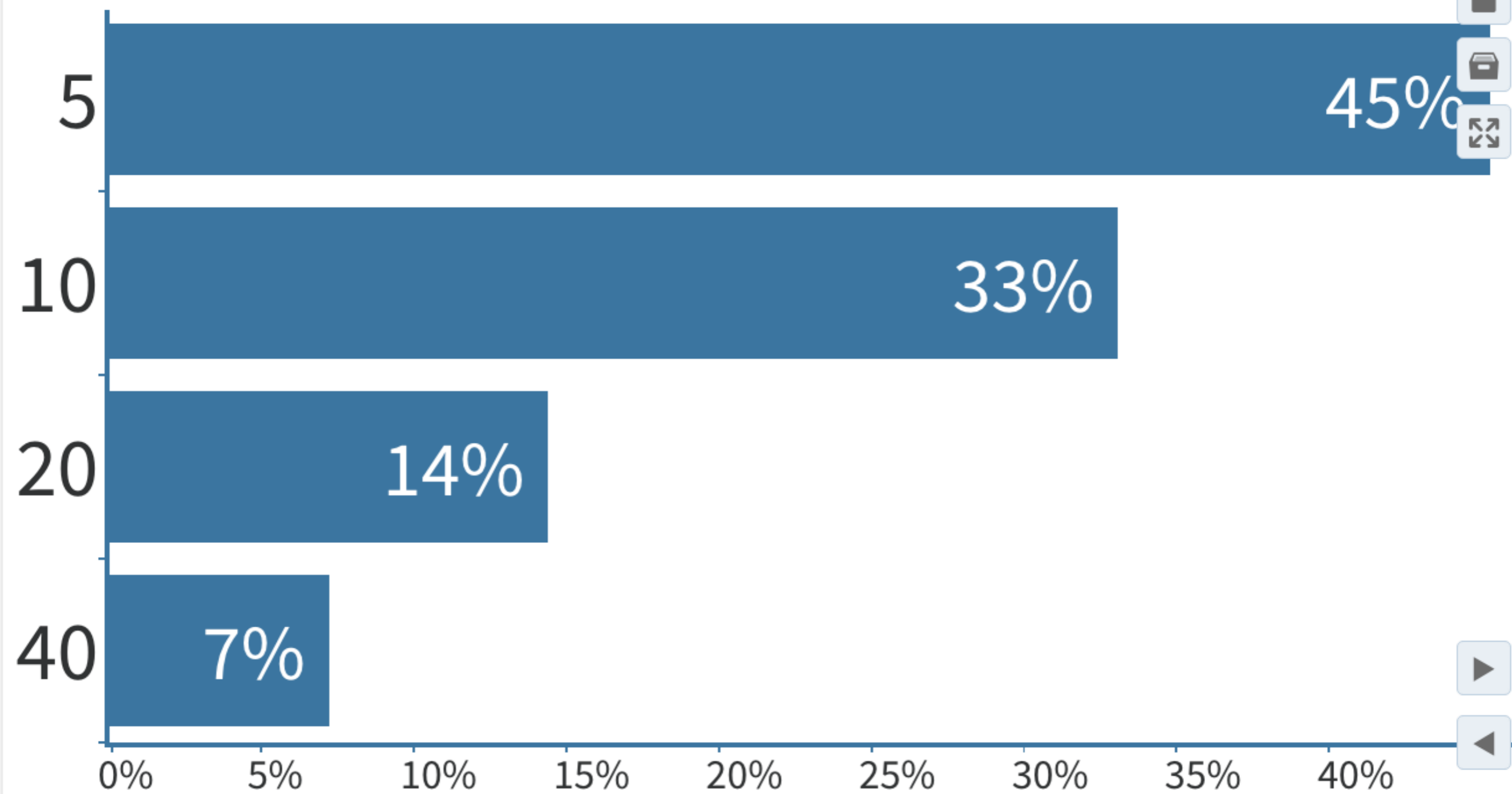
# On Over-Confidence



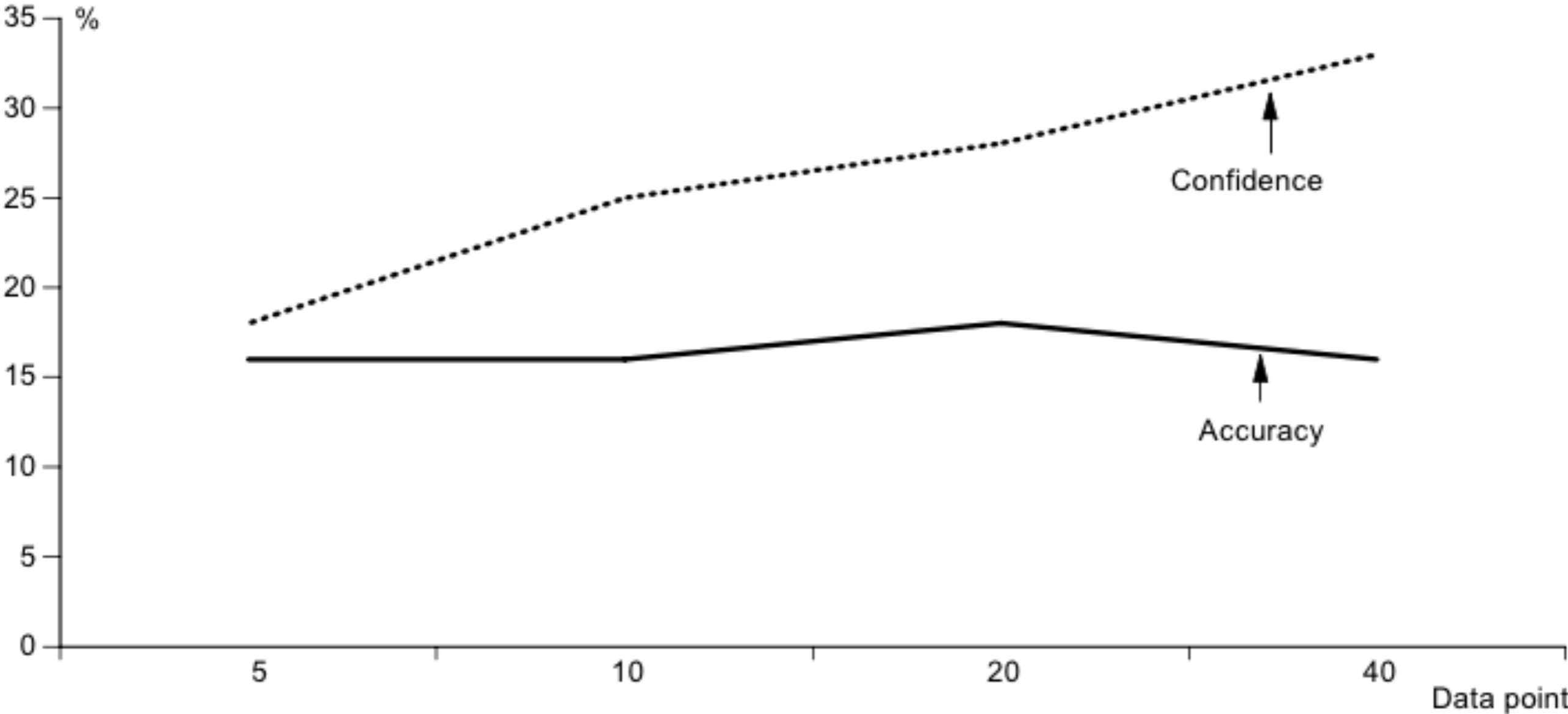
**Poll**

# When buying a stock, how many unique pieces of information would you need to make a good decision?

When poll is active, respond at [PollEv.com/stocko](https://PollEv.com/stocko)



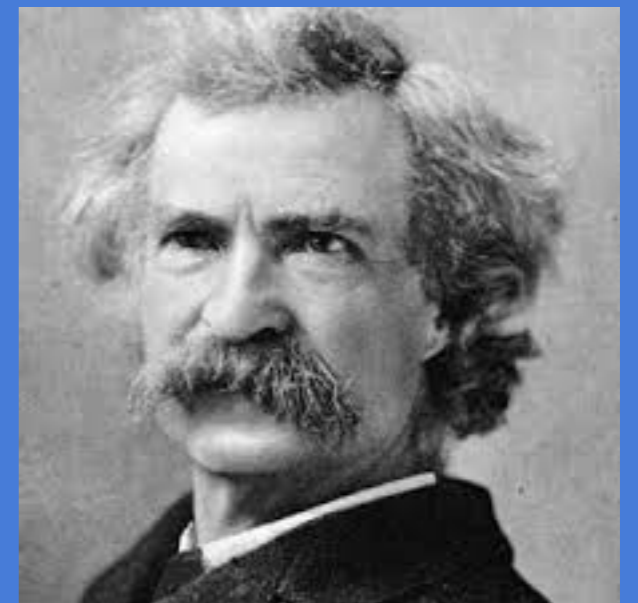
# Accuracy vs. confidence for bookmakers as a function of the information set



Source: Slovic (1973)

"It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."

**Mark Twain**





# Key Takeaway

- Avoid over researching.
- Favour simplicity (5 points) over complexity.
- Stop following your stocks obsessively !

# On Attention

<https://youtu.be/vjG698U2Mvo>



## Instructions

**Count how many times the  
players wearing white pass  
the basketball.**

**But did you see the gorilla?!**

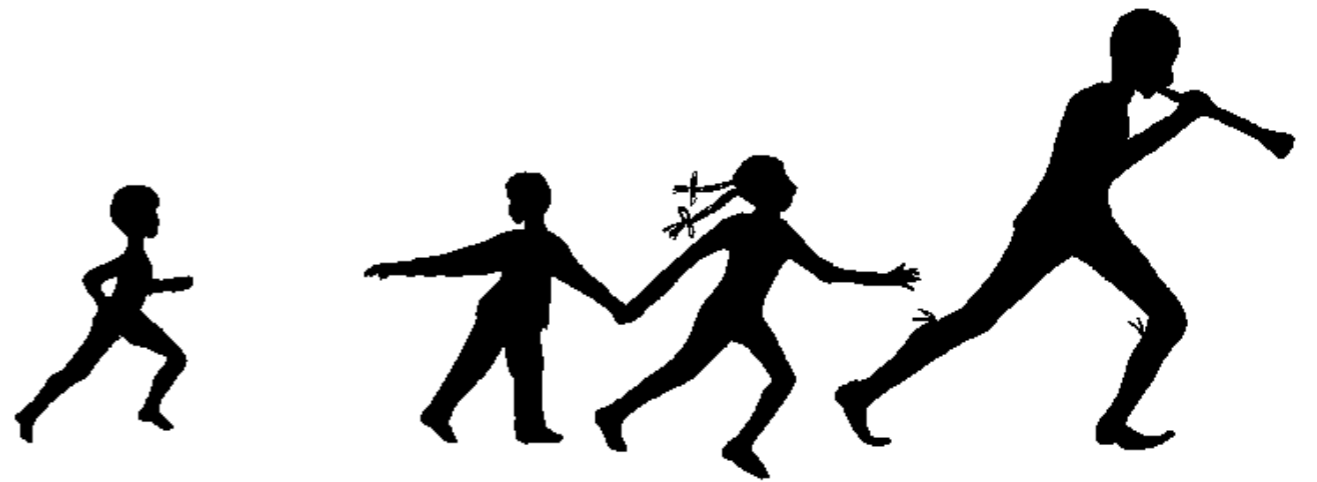


# Key Takeaway

- You are missing the obvious
- Seek contrary opinions
- Ask “what am I missing?”

# On Pied Pipers

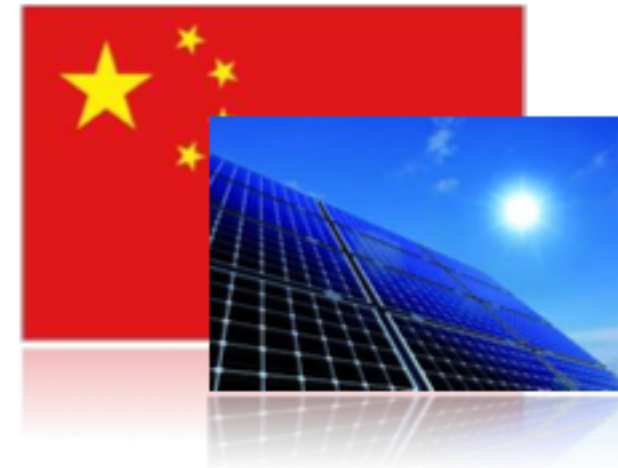
**We are suckers  
for stories**





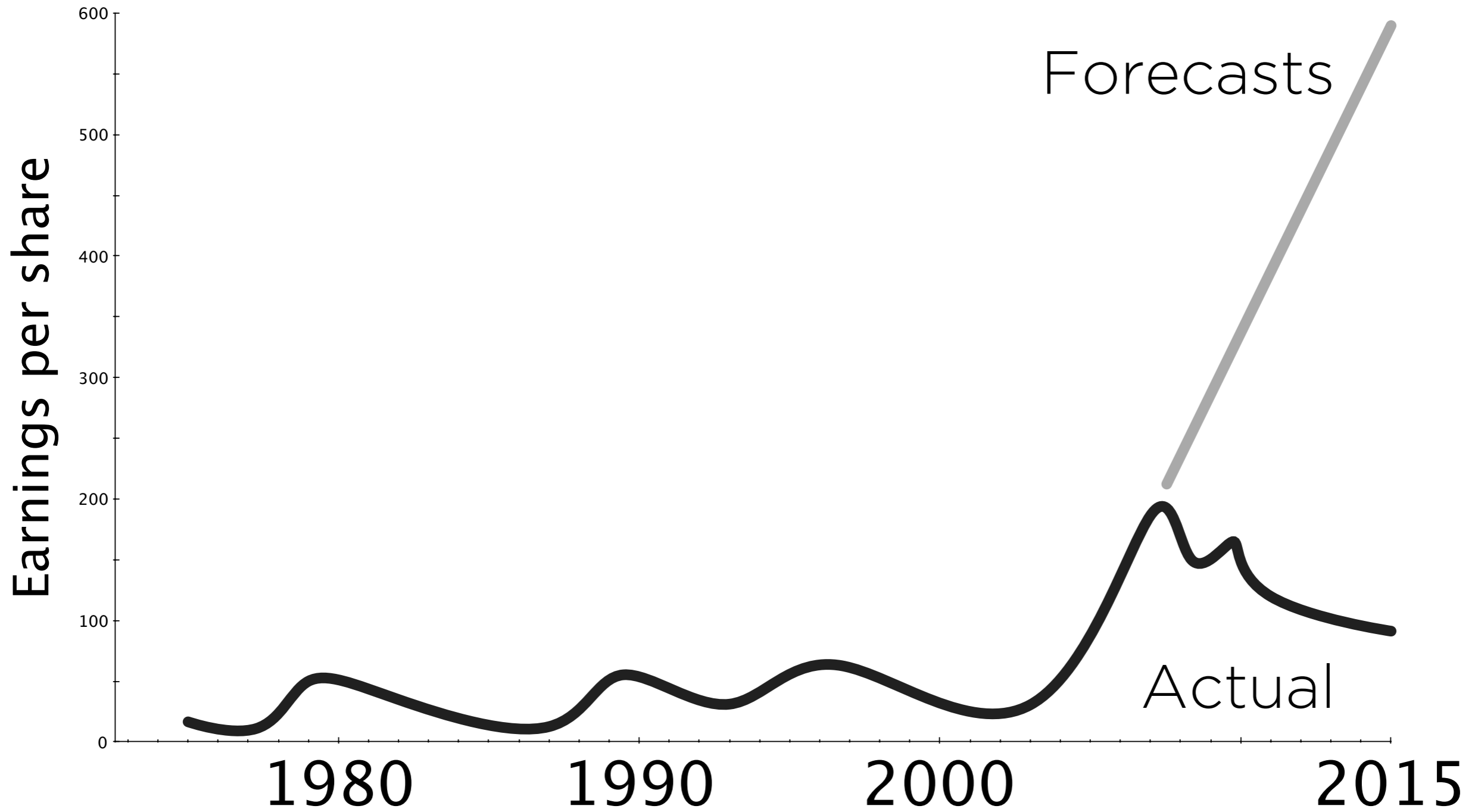
**2000 – Dotcom bubble**

**2007 – China & Renewables**



**2011 – Commodities Supercycle**

# World Mining Sector Forecasts



Source: GMO

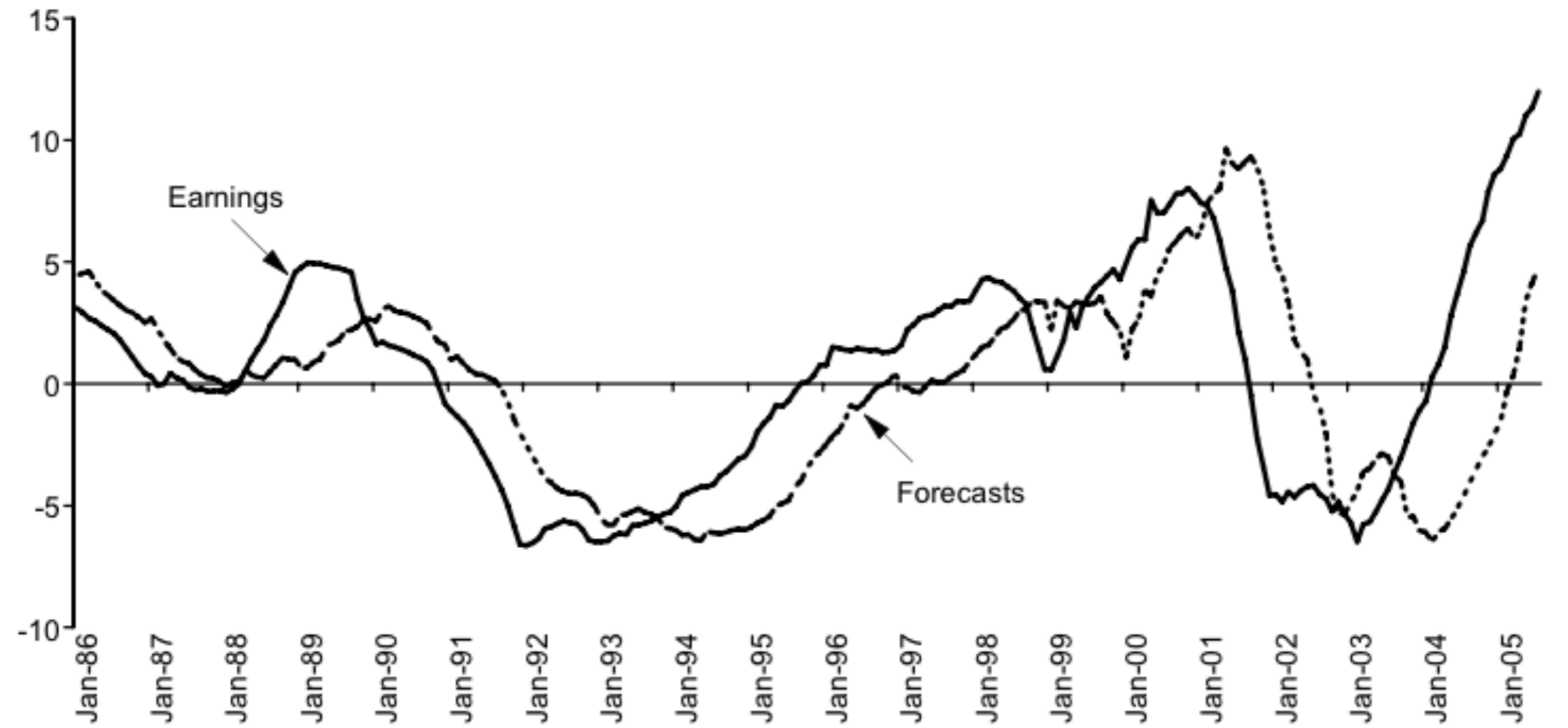
**Analyst forecasts  
are **wrong** by an  
average of **47%****

\*James Montier - Value Investing 2009





## Analysts lag reality (Operating earnings and forecasts, deviations from trend, \$/Sh)



Source: DrKW Macro research



# Key Takeaway

- Don't rely on forecasts
- Beware of “paradigm shifts”

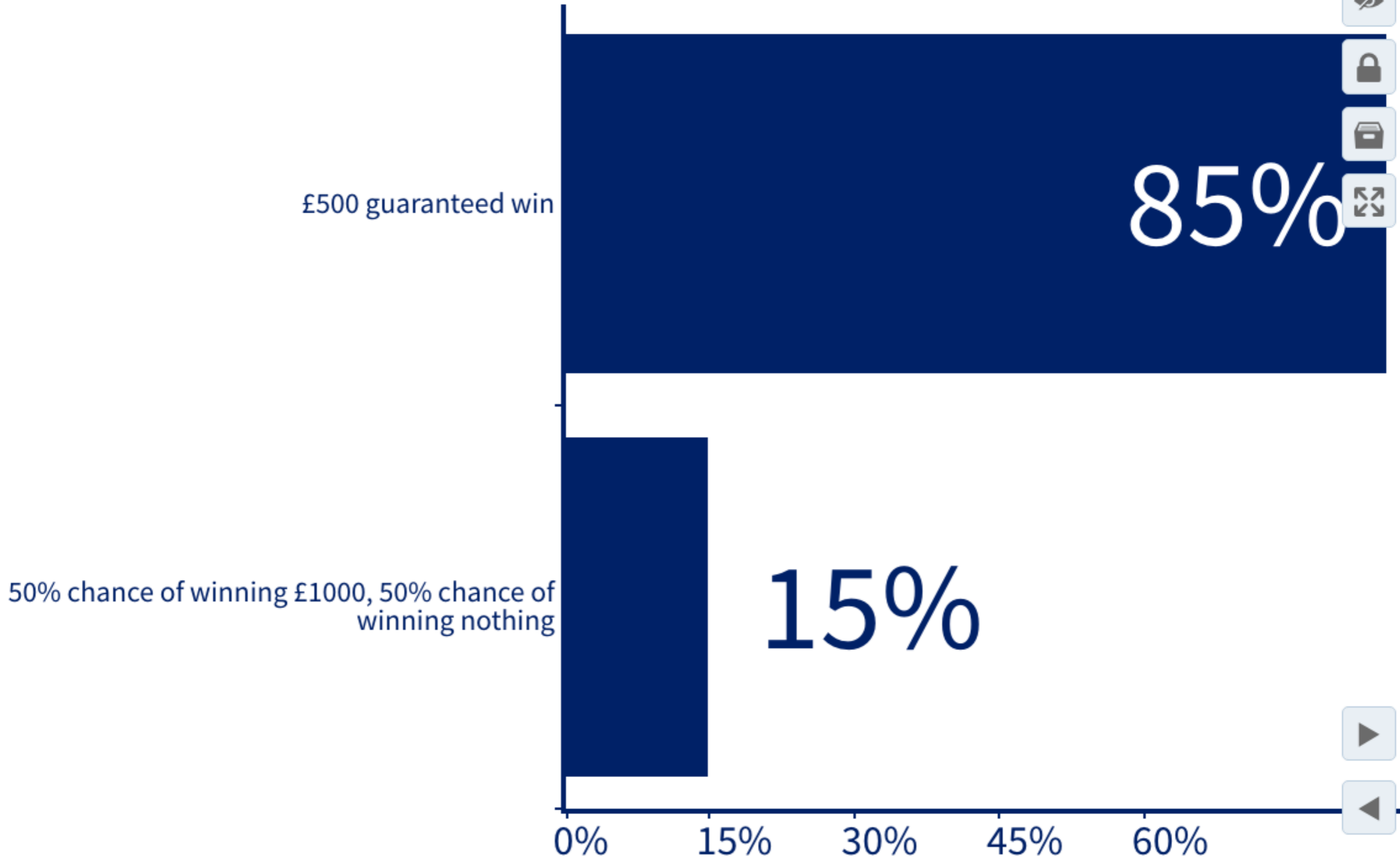
# On running winners and cutting losers



[pollev.com/stocko](https://pollev.com/stocko)

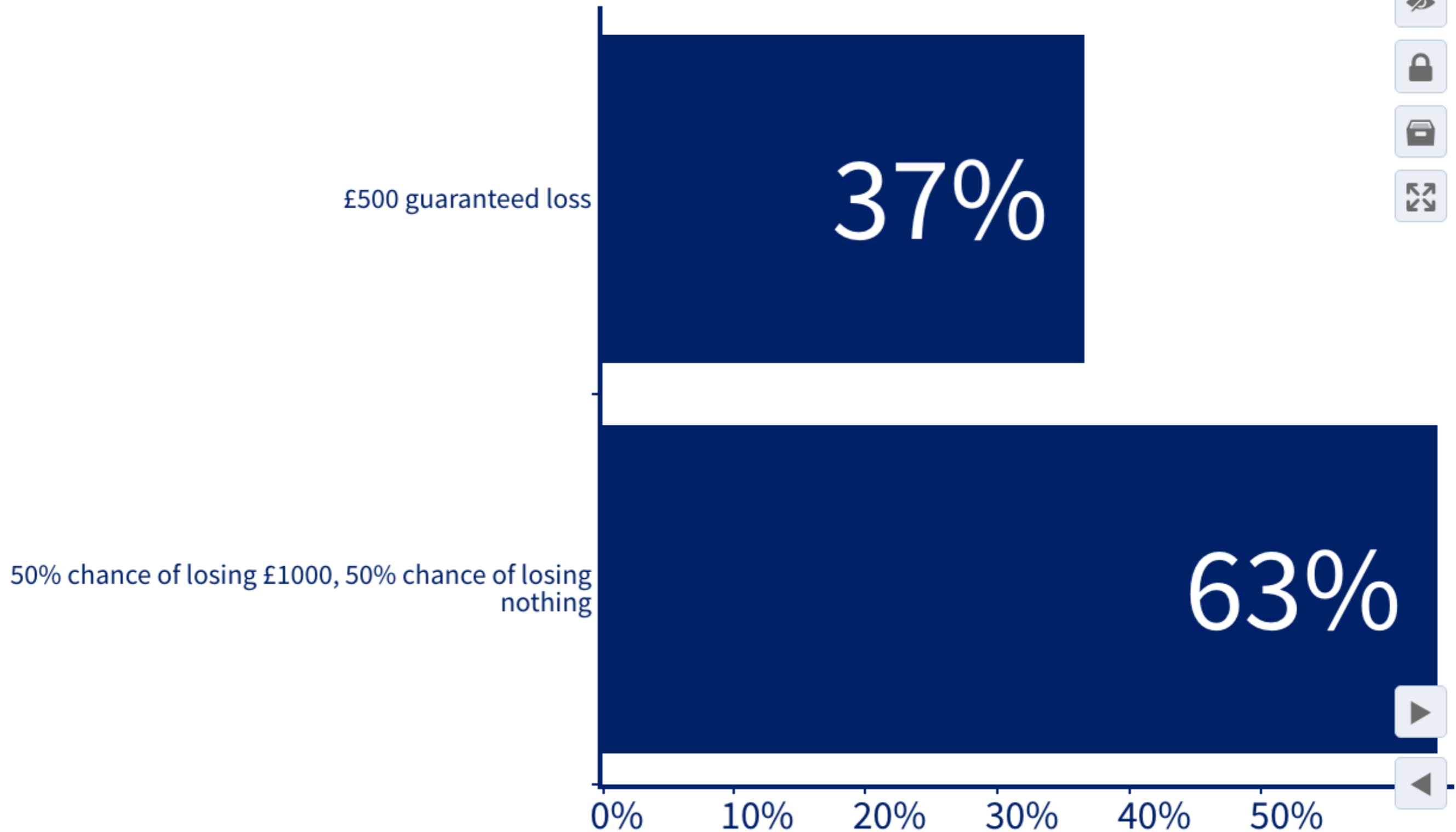
# Which of the following would you prefer?

When poll is active, respond at [Pollev.com/stocko](https://Pollev.com/stocko)



# Which of the following would you prefer?

When poll is active, respond at [Pollev.com/stocko](https://Pollev.com/stocko)



# One week in April last year....



+18% Dart Group

“I’d probably be tempted to bank some gains on today’s big move up.

**(bank a guaranteed win)**



Synety -35%

“I still like the stock and will hold on.... it might look ok this time next year.

**(gamble on a loser)**

# One year on... what actually happened...



+106% Dart Group



-45% Synety

**Dart continued to **rise**, Synety continued to **fall****





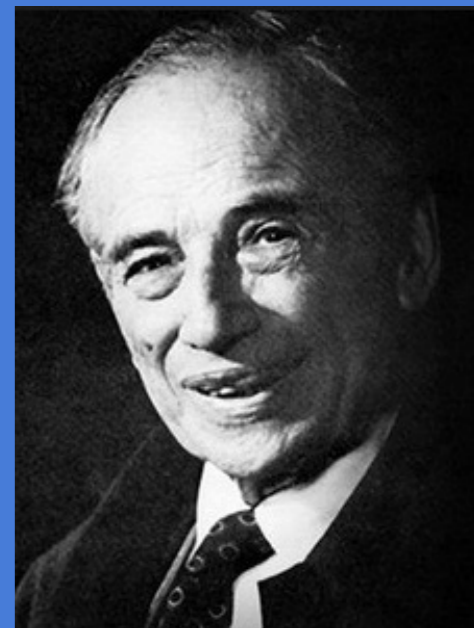
# Key Takeaway

- Fight the disposition effect !
- Sell your losers (no really do!)
- Don't sell on sudden price rises

Help - I'm an idiot...  
**get me out of here!**

“People don’t need extraordinary insight or intelligence. What they need most is the character to adopt simple rules and stick to them.”

**Ben Graham**



“Checklist routines  
avoid a lot of errors.  
There is no other  
procedure in the world  
that will work as well.”

**Charlie Munger**





# A checklist for recovery

1. **Define Buy Rules** - create simple, repeatable process.
  2. **Diversify Risk** - More successful investors diversify across sectors and risks.
  3. **Define Exit Rules** - e.g. stop losses and rebalancing.
- **Trade Less** - trading is hazardous to your wealth !
  - **Keep a Trade Journal** - avoid lying to yourself.
  - **Switch off** - don't look daily and don't look at the news.
  - **Don't discuss with anyone** - unless it's contrary opinion
  - **Ignore forecasts** - they are invariably wrong !
  - **Defer to your wife !!!**

# Simple models work



**James O'Shaughnessy:**  
Tiny Titans - 12% annualised since 1999

P/S	<	1	value
RS 1y	>	0	momentum
Mkt Cap £m	<	150	size
Mkt Cap £m	>	15	
Spread (bps)	<	1000	

Sort by RS 1y

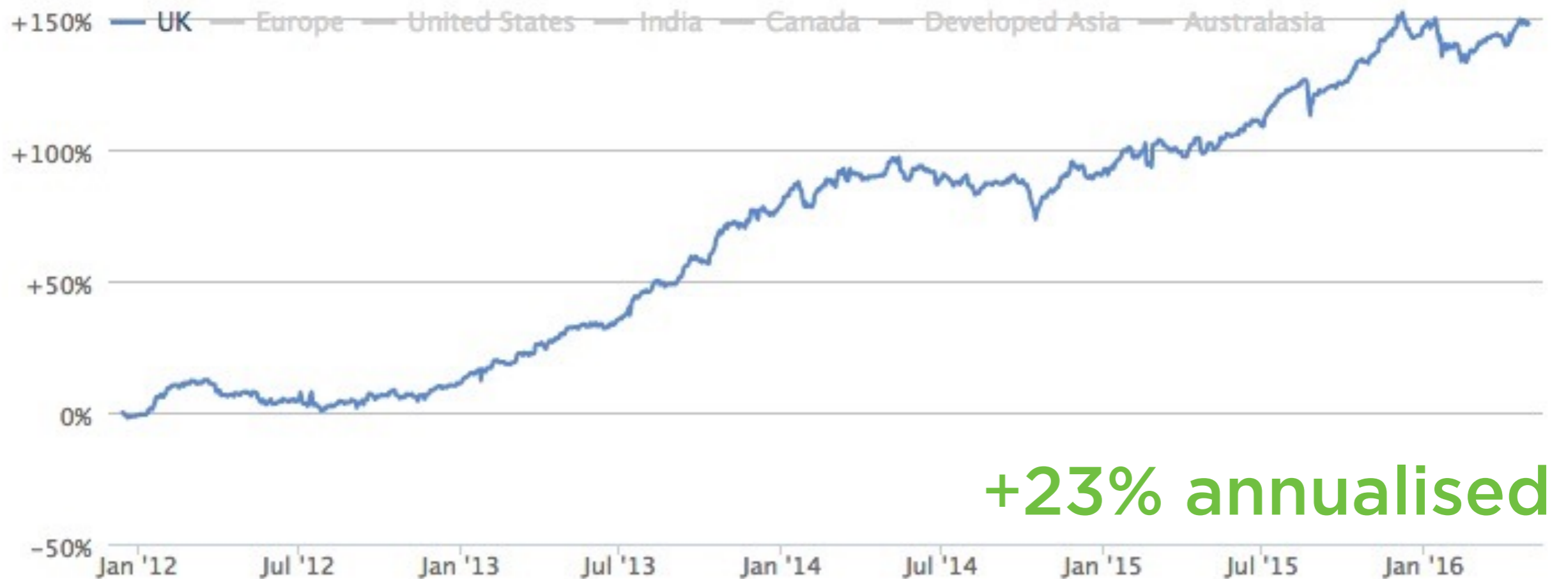
Descending



Get Qualifying Shares

# O'Shaughnessy Screen

Cheap, improving companies



[stk.pe/tiny-titans](http://stk.pe/tiny-titans)

# Clinical vs Mechanical Judgement

Grove, Zald, Lebow, Snitz, Nelson (2000)

Clinical Versus Mechanical Prediction: A meta-analysis, Psychological Assessment, 12

Out of 130 different academic studies, 122 times the rule based process beat human judgement.

In the 8 studies in which it lost the humans had information unavailable to the models.

Average human had a **66.5%** accuracy  
vs quant models **73.2%**.

<http://www.thehedgefundjournal.com/node/7378>



“The evidence is clear: quant models usually provide a ceiling (from which we detract performance) rather than a floor (on which we can build performance). We tend to overweight our own opinions relative to those of the models.

**James Montier**

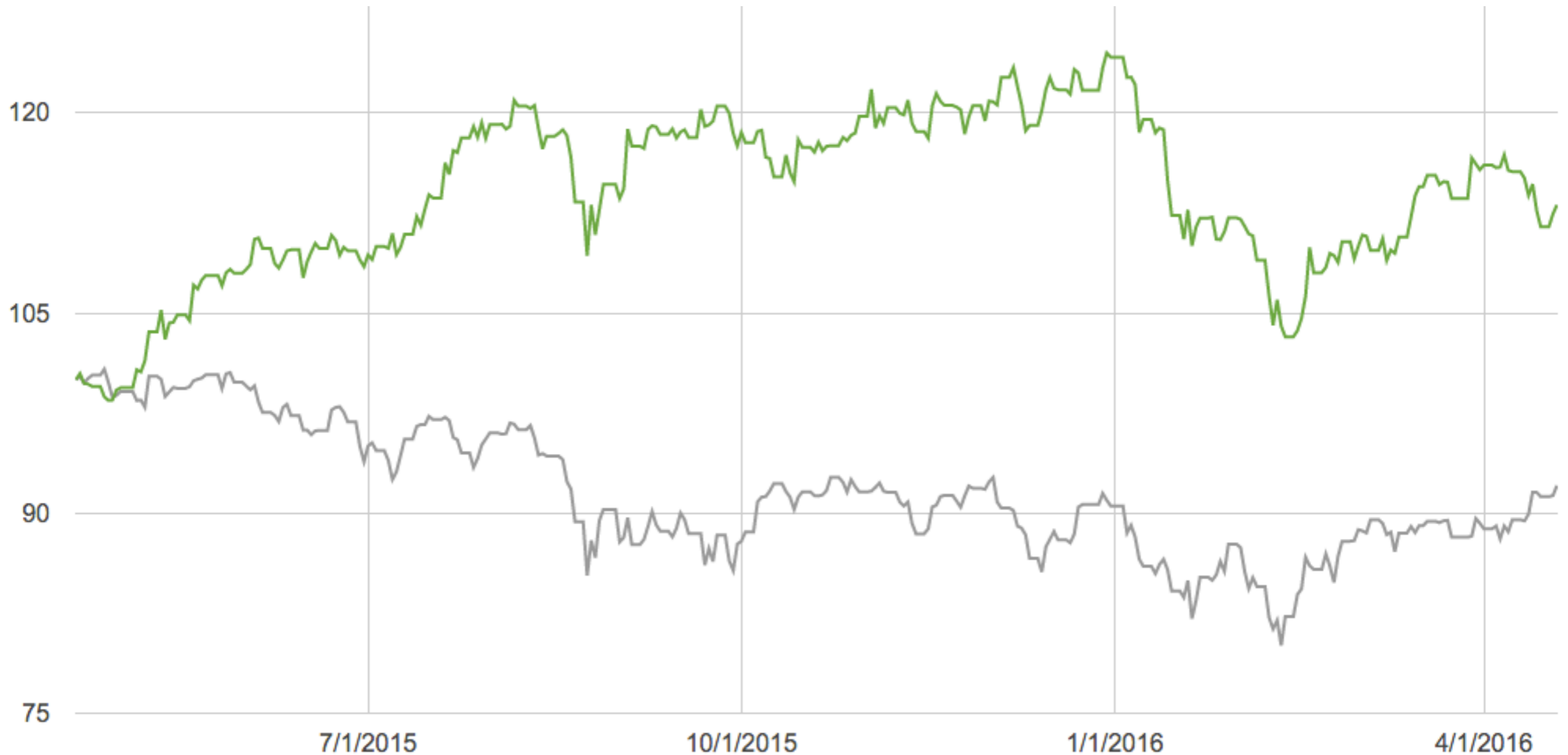
<http://bit.ly/1XJbD9w>



# 5 Rule Based 'Picks'

# Last Year's Picks\*

**Ed's Picks +12.4%** vs **FTSE All Share -8.7%**



\* 1 year holding period from 20th April 2015 to 20th April 2016

# Last Year's 'Picks'\*

	Mkt Cap (then)	P/E (then)	Performance
<u>Berkeley Group</u> (BKG)	£3.6bn	10	<b>+7%</b>
<u>Indivior</u> (INDV)	£1.5bn	14	<b>-15%</b>
<u>Novae</u> (NVA)	£470m	12	<b>+21%</b>
<u>H&amp;T Group</u> (HAT)	£69m	12	<b>+19%</b>
<u>Empresaria</u> (EMR)	£28m	7	<b>+30%</b>

\* 1 year holding period from 20th April 2015 to 20th April 2016

# This Year's 'Picks'

	Mkt Cap	P/E (fwd)
<b>Persimmon (PSN)</b>	£5.9bn	10
<b>Computacenter (CCC)</b>	£1.0bn	15
<b>Headlam (HEAD)</b>	£406m	14
<b>Gem Diamonds (GEMD)</b>	£201m	8
<b>H&amp;T Group (HAT)</b>	£88m	13

\* Top 5 by StockRank (QVM) above £20m split across sectors and market cap bands

# Four Principles

for stock market success

**1. Manage the Monkey**



Rules

**2. Align with the Payoffs**



QVM

**3. Give every stock a role**



Diversify

**4. Keep your balance**



Rebalance

**Join my seminars upstairs  
at 1.20pm and 2.40pm**

 **Stockopedia**

# Additional Material



# Avoid this journey !

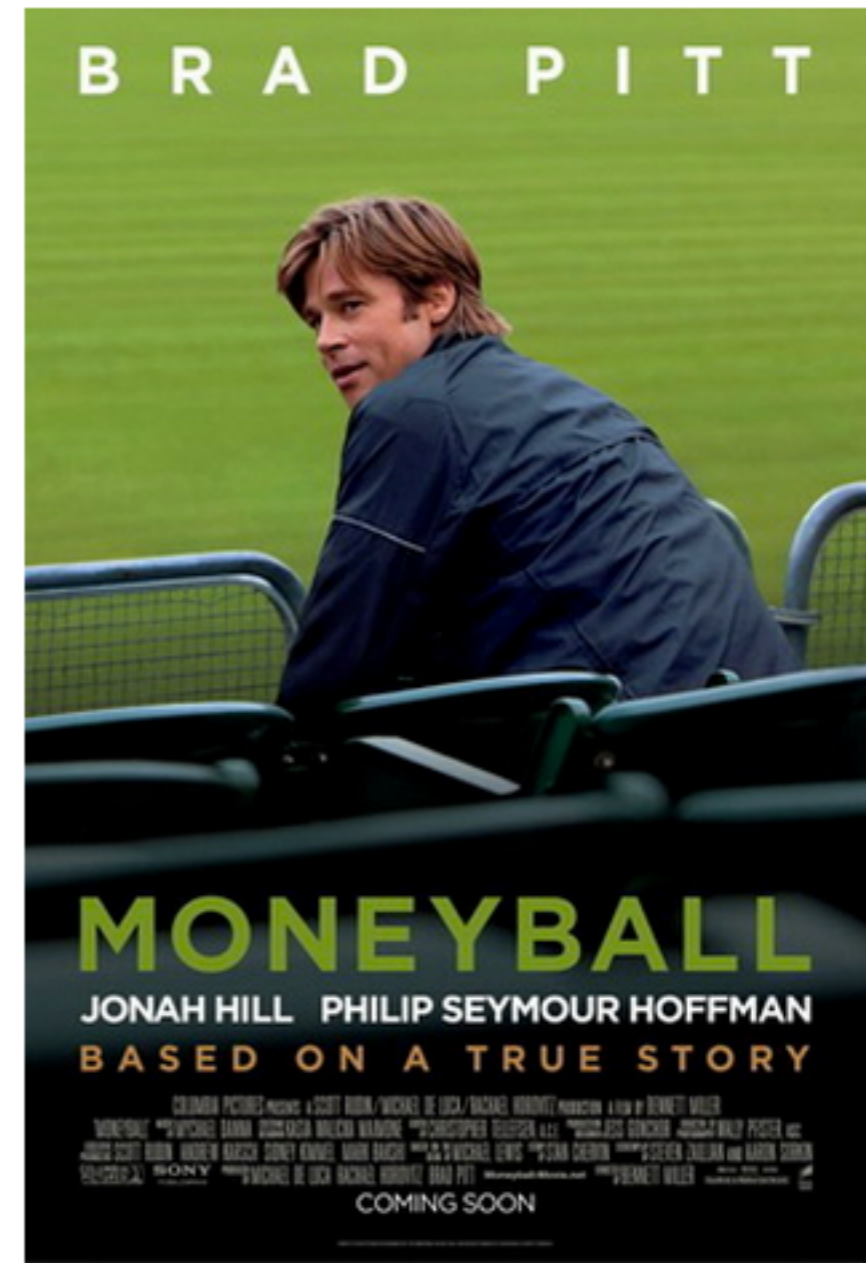
- Most private investors are part timers, and the easiest thing for a part time investor to get their head around is a good story - a 'game changer' stock or 'paradigm shift' theme is ideal. [[narrative fallacy](#)].
- Once we have caught on, we follow the writings of someone (e.g. Jim Cramer or bulletin board guru) who seems to be incredibly confident on the subject and know far more than we do [[authority bias](#)].
- As we research the idea, we gather more and more information to confirm to ourselves that we are right while selectively tuning out contrary arguments [[confirmation bias / inattention blindness](#)].
- We find ourselves drawn to discussing the topic on bulletin boards with people who share the same ideas [[herding, social proof](#)] and we start to become extremely sure in our predictions [[overconfidence](#)].
- If our position does go against us we double down and resolve to stick to it and/or get even. [[anchoring & loss aversion](#)].

# Statistics vs Human Judgement

## Go Read



## Go Watch



# Essential Reading

