

KNOW YOUR BEHAVIOURAL BIASES

- Making Better Decisions
During Turbulent Times



May 2020



| Foreword

Global markets, India being no exception, have taken a significant beating following the outbreak of Covid-19 pandemic. While an erosion in value of investments does worry an investor, it brings to the forefront two pertinent questions:

1. Can you control what is happening in the market?
2. Can you control how you react to what is happening in the market?

The answer to the first question is "No". As far as the second question is concerned, the answer is "Yes", but it is easier said than done.

Most conventional economic theories that were path-breaking discoveries of the 20th century made a fatal assumption that people are rational, thereby overlooking a key aspect governing human behaviour.

Over the last 30 years, a lot of ground has been covered on this subject suggesting that it's time to accept that humans are emotional and are subject to cognitive biases. These biases, from time to time, come in the way of effective decision making concerning each and every aspect of our life, including personal finances.

In this edition of 'Know your behavioural biases' booklet, we have tried to elaborate the biases that individual investors commit, thereby endangering their hard earned wealth. As with most complex problems, the solutions thereof are often simple, and dealing with behavioural biases is no exception. Herein, we present simple yet effective and easy methods to know, accept and overcome these biases.

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The investor's chief problem – and even his worst enemy – is likely to be himself.

– Benjamin Graham

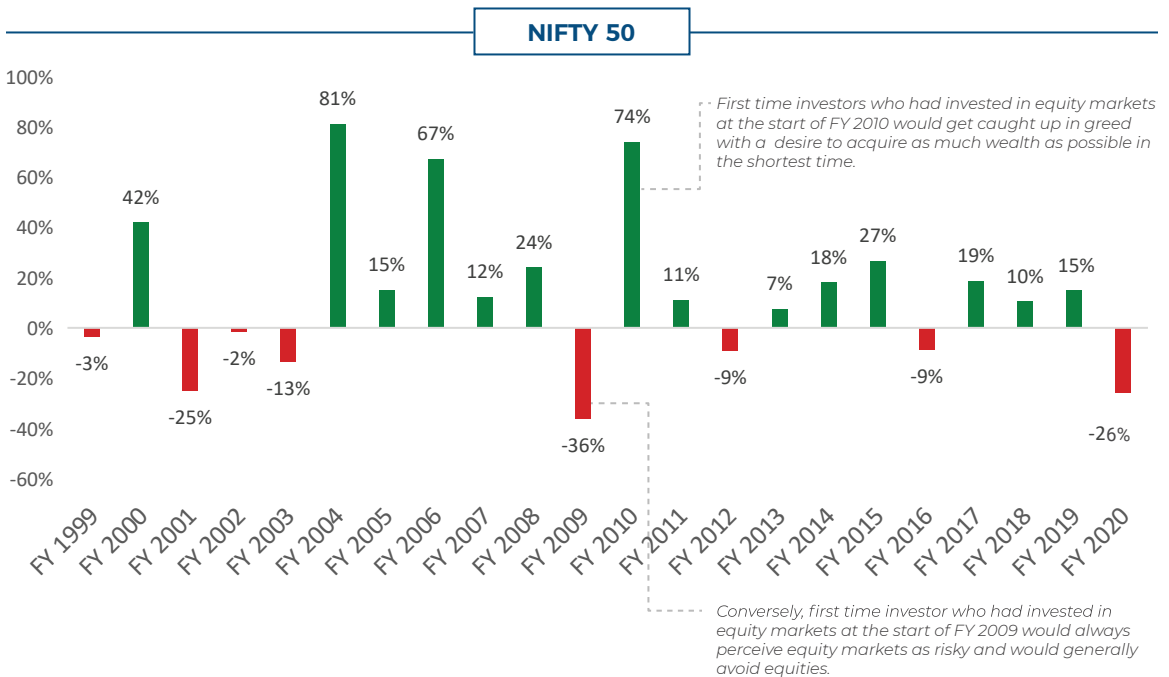
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How to Respond to Market Cycles?

Greed and Fear in Market Cycles

Investor's experience in the markets is one of the most important factors that determines his/her investment decisions. For example, someone who began investing during the negative phase of the markets (e.g. year 2001 – IT Bubble, 2009 – Global Financial crisis) will prefer to avoid equities compared to an individual who has had a good investment experience (year 2010).



Source: MFI

The above chart is shown for illustrative purpose to explain the concept. Historical performance indications and financial market scenarios are not the reliable indicator for current or future performance.

Past performance may or may not be sustained in future. Investors are requested to consult their financial advisor before making any investment decisions.

Even during the current market cycle, when the stock prices are down drastically, it makes sense for a beginner investor to enter equities through SIPs. Once they have gone through the bull and bear phase of the market and are familiar with market volatility, they can gradually increase their allocation to equities in mutual funds.

“

To err is human; to admit it, superhuman.

- Doug Larson

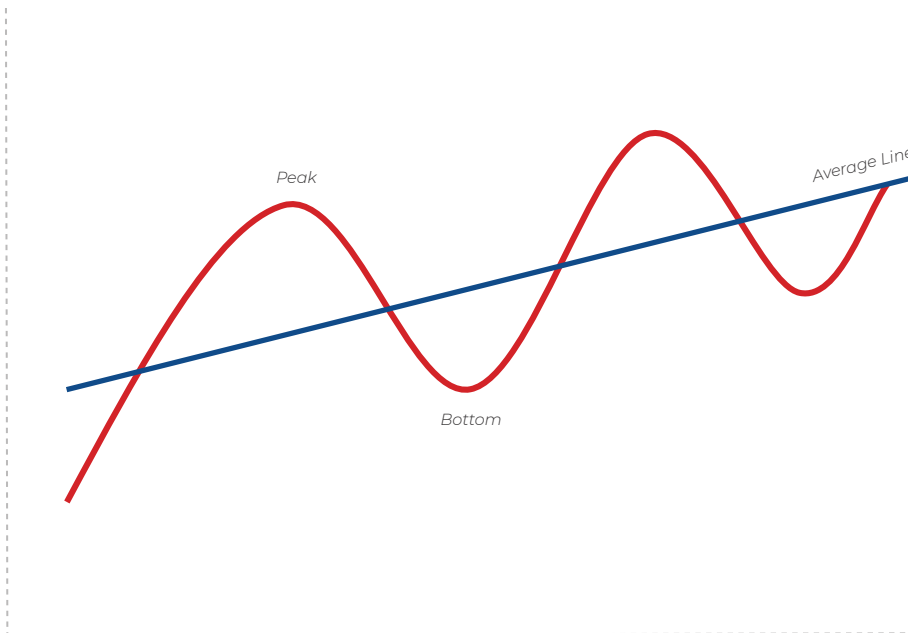
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Understanding Market Cycles

Markets are not linear and move in cycles.

Along with the economy and business, markets also go through periodic expansions and contractions. Periods of expansions are characterized by business optimism and increase in business profitability. Conversely, periods of contraction are characterized by business pessimism and decline of business profitability. Markets anticipate these fluctuations and move ahead.

The long term average trends across cycles are typically upward sloping in a growing economy as economies, corporate profits, consumption levels, etc. grow at positive rates in the long run.



From an investors' perspective, the turning points in business cycles are hugely important. Investors who can position their portfolios in line with the cyclicity of the markets can make a fortune. This is different from timing the market, which can be fraught with risks.

Understanding of cycles can help an investor position the overall portfolio with varying allocation to different asset classes. When it comes to individual investments, adopting an SIP route would be ideal.

What to see around you?

Peak of a cycle

- Economy is strong; reports are **positive**
- Earnings **beat expectation**
- Media is full of **good** news
- Everyone around you is **confident**, optimistic and greedy
- People are **ready** to take risks
- Defaults are **few**
- Skepticism is **low**
- **Euphoria** everywhere
- **Difficult to imagine** things going wrong

This is the time for caution!

Bottom of a cycle

- Economy is slowing; reports are **negative**
- Earnings are **flat or declining**
- Media report only **bad** news
- Everyone around you is **worried**, depressed and fearful
- People are **not ready** to take risks
- Defaults **soar**
- Skepticism is **high**
- **Panic** everywhere
- Everyone assumes things **will get worse**

This is the time for aggression!

Is it time to be aggressive or defensive?



SIP - A tool to override emotions

It is very difficult to stand against the tide – emotions play you up. However, to reduce your emotional involvement in decision making, you need to automate a few investments, particularly for goals which are a few years away.

A SIP helps in managing emotions during extreme market conditions. It helps you to continue investing when there is pessimism and restricts aggressive equity investments when everything looks bright.



How SIP helps tide over market cycle

- **Rupee cost averaging** - implies averaging out cost at which you buy units. Fixed investments at periodic intervals through SIPs ensures that one ends up purchasing units at different NAVs over a period of time
- **Helps overcome 'fear' and 'greed'** - Continuing SIPs over the long period not only helps you ride the market volatility but also helps you ignore market noise and overcome greed and fear.
- **Disciplined investing** - Sustained disciplined investment through SIPs ensures that more and more units are being accumulated at lower NAVs during market downturns and gradually over time market value outpaces average cost of investment
- **Power of Compounding** - With long tenure SIPs, as the number of years increase, the money compounds at a much higher rate.

SIP - Systematic Investment Plan

“

The simplest solution is almost always the best one.

- William of Ockham.

”



Loss Aversion Bias

Losses are felt much more than gains of similar value. People do not treat gains and losses in a linear way. It feels better to not lose Rs.100 than to gain Rs.100

I hate losing more than I love winning

Loss aversion is the tendency to avoid loss over maximizing gains.

Lets consider 2 scenarios:

Scenario 1:

While you are walking, you find a Rs 500 note lying on the ground. You pocket it and feel happy about it.

Scenario 2:

While you are walking, you find a Rs 2000 note lying on the ground. You pocket it and subsequently someone picks your pocket and you loose Rs 1500 (say from other pocket)

Which scenario will make you happier?

Payoff from both the above scenarios are same but the emotional outcomes are different. A loss of Rs 1500 gave you more pain than gain of Rs 2000.

Similar experience is observed in investing; consider the below scenarios:

- Investment with cost price of Rs 1000 is sold at Rs 2000
- Same investment has touched a high of say Rs 3000 and is now trading at say Rs 2000, the pain from notional loss of Rs 1000 will be much more compared to the overall gain on the investment

An investor with net worth of Rs 1 cr looks at loss and gain of Rs 1 lac as



This is evident from the fact that investors prefer Fixed Deposits over instruments with variable returns but with an ability to beat inflation more effectively

Pain or Joy, We Remember only Extreme Cases

We all prefer pain to be brief and joy to last longer. Lets consider the below example where you are under medication and have to undergo either of the two options below:

- An injection every day for the next 20 days
- An injection, which is 20% more painful, everyday for the next 12 days



Individuals tend to remember the intensity of the pain whereas duration of Pain / Joy is often ignored. Since under option 2, pain is 20% higher, most individuals will prefer option 1.

Similarly, in investments, time correction does not affect emotions as much as price correction. Investors often remember negative events like “Black Mondays”, “Tragic Tuesdays”, etc. Investors often ignore the fact that a big fall in markets on a single day followed by a slow recovery is similar to markets staying flat/ remaining range bound mode over a year.

EMI schemes, Personal Loans, Women’s Kitty Party all follow similar concept

How to Deal with Loss Aversion Bias?

Free yourself of emotions as much as possible

- Do not invest directly in volatile asset classes like equity
- Choose a professional fund manager
- Also take the help of an Investment Advisor
- Adopt a portfolio approach and do not focus too much on each individual investment. Leave the job of product / scheme selection to the Investment Advisor
- Investing is better left to experts.
- Mutual Funds (MFs) are cost effective and convenient.

“

Investing isn't about beating others at their game. It's about controlling yourself at your own game.

–Jason Zweig

”



What is Mental Accounting?

It shows how individuals separate their budget into different accounts for specific purposes.

Mental Accounting : Money Jar Fallacy

Mental accounting, a behavioral economics concept introduced in 1999 by Nobel Prize-winning economist Richard Thaler, refers to different values people place on money, based on subjective criteria, that often has detrimental results.

The concept of mental accounting is beautifully explained by Thaler and Cass Sunstein in their book **Nudge: Improving Decisions About Health, Wealth and Happiness** through the example of Hollywood actors Gene Hackman and Dustin Hoffman.



As Thaler and Sunstein write, 'Hackman and Hoffman were friends back in their starving artist days, and Hackman tells the story of visiting Hoffman's apartment and having his host ask him for a loan. Hackman agreed to the loan, but then they went into Hoffman's kitchen, where several mason jars were lined up on the counter each containing money. One jar was labelled 'rent', another 'utilities', and so forth. Hackman asked why, if Hoffman had so much money in jars, he could possibly need a loan, whereupon Hoffman pointed to the food jar, which was empty.' This example clearly tells us that in the minds of human beings cash or money or even wealth is not fungible.

Mental Accounting and Investments

People also tend to experience mental accounting bias in investing. When it comes to investing, mental accounting can also cause people to make illogical decisions.

Example 1

Salary Income

- *Invest in safe assets*
- *Pain of loss is greater*

Windfall Gains

- *Take risks by speculating*
- *Don't mind losing money*

Investors invest their wealth based on the source of income. Higher weightage is given to hard earned money like salary as investors usually prefer to take lower risk while investing their salary income. An investor who is young should ideally have a higher portion of his/her wealth in equities. However, since there is an emotional attachment to hard earned money; he may not be willing to invest a larger portion of his salary income in equities. (as equities are perceived as a risky asset class). The same investor when faced with windfall gains tends to take higher risk with that amount.

Mental Accounting and Investments

Example 2 - Investment with a Loss

Own Research

- *Unable to accept the mistake and hold on to the investment*

Advise by another person

- *Investors tend to book the losses immediately*

Value of money remains the same for an investment made on the advice of a distributor or through own research. However, when evaluating a loss making investment, investors tend to hold on to the same forever if the initial decision to buy was that of the investor himself / herself (as booking a loss hurts his ego). The emotion of regret is in play here. On the other hand, if the initial decision to buy the investment was as per the recommendation of another person, say, the advisor, the investor would be willing to sell the asset at some point and move on. This decision to sell is taken at the cost of diversification.

To avoid the mental accounting bias, individuals should treat money as perfectly fungible when they allocate among different accounts, be it a budget account (everyday living expenses), a discretionary spending account, or a wealth account (savings and investments). But it is easier said than done.

Other Examples of mental accounting

Overspending on credit card rather than cash

More impulsive buying on a shopping trip could be attributed to the use of credit cards as compared to giving away cash. However, 'money' is 'money'.

Tax Refunds

Tendency to treat tax refunds as a windfall gain and use it for discretionary spending.

Categorizing money as "Safety Capital" and "Risk Capital"

Investors often categorize portions of their wealth as "Safety Capital", something that they can never afford to lose (example - salary) and "Risk Capital", money that they OK to see depreciate, (example - windfall gains).

Money that you "don't mind losing"

Investors, at times, invest in safe instruments and transfer the appreciation thereof to riskier asset classes, with the mindset that this component is something that they don't mind losing?

Yearly bonus

Habit of treating yearly bonus differently to monthly salary and spending it lavishly. This behavior is like that of a kid spending birthday money on immediate gratification.

Would you spend your EPFO corpus on a foreign holiday?

There is a guilt factor associated with spending money earmarked for an important goal like retirement planning on a lavish need.

Use Mental Accounting to Your Advantage

Invest with a Goal!

Once you attach a goal to a particular investment, you mentally allocate that money to a particular purpose. Further, it:



Helps target a specific amount of corpus for your retirement/children's education or any other goal



Helps investors rationalize their spending on other personal/ social requirements



Helps inculcate discipline among investors



Balance your current aspirations vis-à-vis future requirements



Encourages long term holding of investments due to which a sizable corpus is built overtime

Mutual Fund schemes are available for specific financial goals like Retirement Planning and Children's Education, as defined by SEBI in mutual fund categorization



Herd Mentality

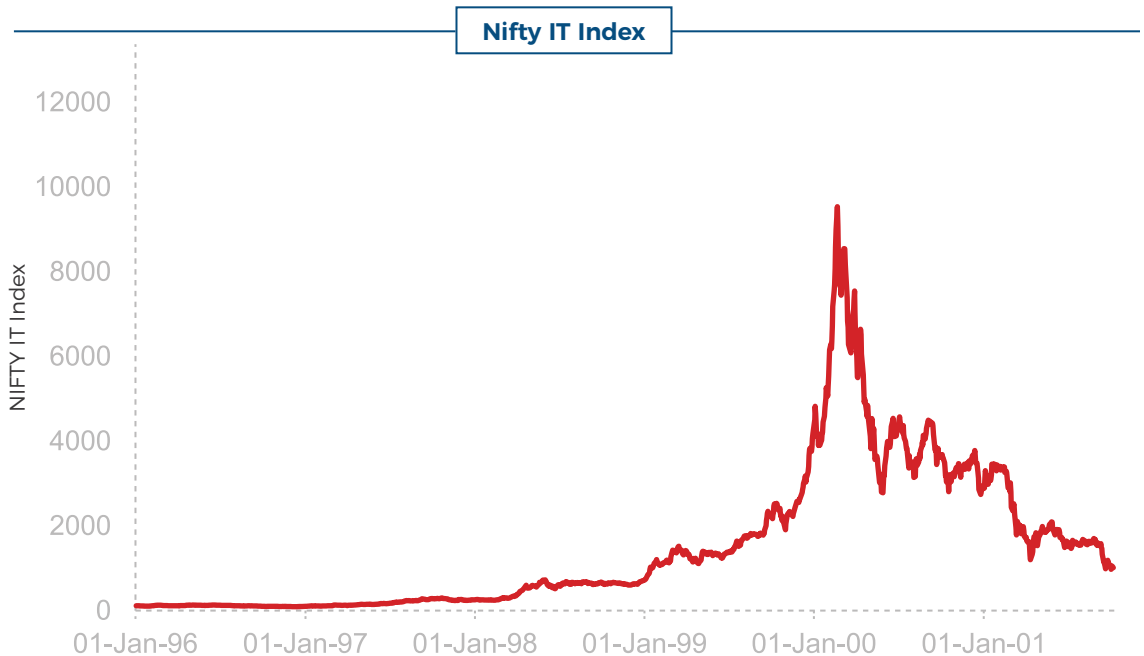
It is the phenomenon where investors follow what other investors are doing, rather than following their own analysis and risk appetite and is often driven by the fear of missing out

Fear of Missing Out – Have you felt that?

It is normal to get tempted by prospect of becoming rich quickly. When the markets are on their way up, it gets very frustrating for an onlooker to see people create wealth just by being invested in the market. More often than not, a prospective investor gets enticed to invest when he sees quick gains being made by others around him.

This mentality is often the result of a reaction to peer pressure which makes investors act in order to avoid 'feeling left out' or 'left behind' from the group. In the quest to earn quick gains from his investments, investors often chase returns by following the herd.

In the process of following the herd, investors usually end up with the portfolio that is more risky and may not be appropriate as per his/her risk appetite. The outcome has always been a disappointment in terms of returns.



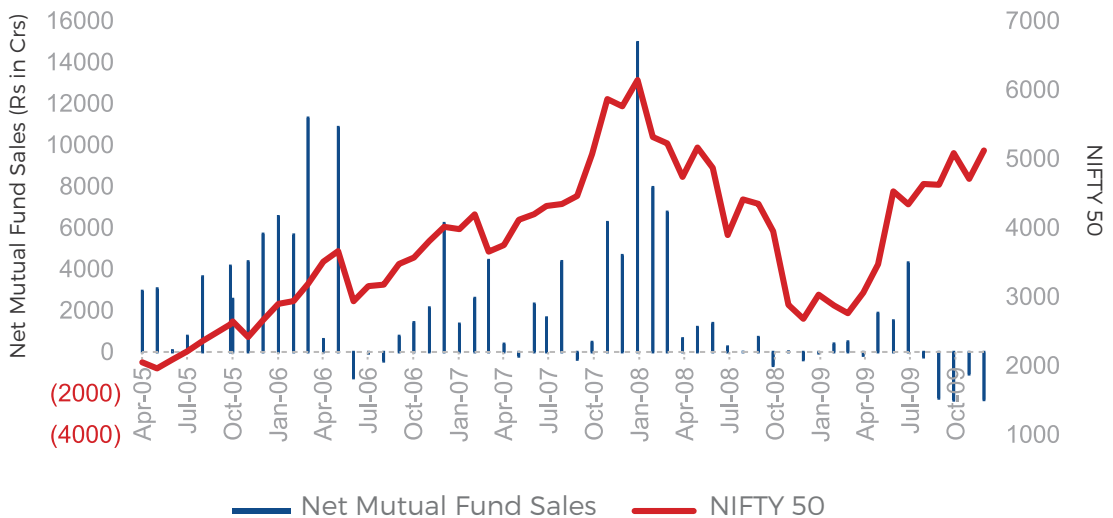
Source: MFI

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A classic example of herd behavior occurred in the late 1990s. Investors followed the crowd and invested in stocks of IT companies, even though many of them were loss making and were unlikely to generate significant revenues in the foreseeable future.

Herding = Lazy Thinking



Source: AMFI & MFI

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Similar trend was seen in 2007-08; the chart shows flows in Equity Mutual Fund and NIFTY50 price movement.

It is often observed that investors confidence level, index level and equity allocation usually move in tandem and the result has been the largest chunk of their wealth is invested almost at the peak of the cycle.

Investors that follow the herd are left disappointed to see negative returns at the end of the cycle. This is mainly because investors focus turn to the conduct of the herd in search of earning quick returns instead of fundamentals of the economy, company, etc. that might be more relevant.

“

The four most dangerous words in investing are: 'this time it's different'.

– Sir John Templeton

”

Let Asset Allocation Guide You to Overcome Biases

| Fiscal Year | Returns | | | Asset Class Rank | | |
|-------------|---------|------|------|------------------|------|------|
| | Equity | Debt | Gold | Equity | Debt | Gold |
| FY 1999 | -3% | 13% | -2% | 3 | 1 | 2 |
| FY 2000 | 42% | 19% | 2% | 1 | 2 | 3 |
| FY 2001 | -25% | 13% | 0% | 3 | 1 | 2 |
| FY 2002 | -2% | 29% | 22% | 3 | 1 | 2 |
| FY 2003 | -13% | 17% | 8% | 3 | 1 | 2 |
| FY 2004 | 81% | 13% | 16% | 1 | 3 | 2 |
| FY 2005 | 15% | -5% | 1% | 1 | 3 | 2 |
| FY 2006 | 67% | 2% | 39% | 1 | 3 | 2 |
| FY 2007 | 12% | 6% | 11% | 1 | 3 | 2 |
| FY 2008 | 24% | 8% | 30% | 2 | 3 | 1 |
| FY 2009 | -36% | 10% | 24% | 3 | 2 | 1 |
| FY 2010 | 74% | 0% | 8% | 1 | 3 | 2 |
| FY 2011 | 11% | 5% | 28% | 2 | 3 | 1 |
| FY 2012 | -9% | 3% | 32% | 3 | 2 | 1 |
| FY 2013 | 7% | 11% | 3% | 2 | 1 | 3 |
| FY 2014 | 18% | -1% | -11% | 1 | 2 | 3 |
| FY 2015 | 27% | 15% | -4% | 1 | 2 | 3 |
| FY 2016 | -9% | 8% | 10% | 3 | 2 | 1 |
| FY 2017 | 19% | 12% | -1% | 1 | 2 | 3 |
| FY 2018 | 10% | 0% | 8% | 1 | 3 | 2 |
| FY 2019 | 15% | 6% | 4% | 1 | 2 | 3 |
| FY 2020 | -26% | 14% | 36% | 3 | 2 | 1 |

- Asset classes move in cycles and no single asset class continues to outperform or underperform.
- Historical returns tend to bias investors towards the asset class which has performed well recently.
- However, this could result in investors chasing momentum and picking an asset class at an inopportune time.
- Over the last 20 fiscal years equities, debt and gold have outperformed each other at different times.
- Asset allocation and diversifying across asset classes can help investors avoid such biases

Who is happiest during this current episode of equity market volatility?

The answer to this question would be the one who had done asset allocation to some extent. An investor with higher than required equity exposure, obviously, has reasons to worry as the value erosion in portfolio would be felt the maximum. On the other hand, even an investor with zero or very low equity exposure has little reason to rejoice, as it is difficult to take the emotional decision of entering equities in these volatile times, in fact, the investor would strengthen her resolve to never touch equity, an asset class that potentially erode in value in such quick time.

An investor with a more balanced allocation to various asset classes including, equities, fixed income, real estate, gold, etc. is likely to be happiest despite one particular asset class decreasing in value. The very reason to do asset allocation is the uncertain nature of each asset classes and is acknowledgment of preparing for rainy days in a particular asset class.

Source: Bloomberg. Data for last 20 fiscal years. Mar '98 to March '20.
Proxies used for asset classes: Equity - NIFTY 50, Debt - NIFTY 10 year benchmark G Sec, Gold - Spot Rate ₹10/Grams

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Emotional Attachment to Inherited Wealth: Endowment Bias

causes individuals to value an owned object higher, often irrationally

How to treat Inherited Investments?

You recently inherited a flat worth Rs 3 cr from your grandfather

Portfolio before Inheritance

| Asset | Rs in cr | % |
|-------------------------|----------|-----|
| Equity | 3 | 30 |
| Debt | 5 | 50 |
| Real Estate (own house) | 2 | 20 |
| Total | 10 | 100 |

Portfolio after Inheritance

| Asset | Rs in cr | % |
|---------------------------------------|----------|-----|
| Equity | 3 | 24 |
| Debt | 5 | 38 |
| Real Estate (own and inherited house) | 5 | 38 |
| Total | 13 | 100 |

The above table is shown for illustrative purpose to explain the concept.

Investors are emotionally attached to the inherited asset and give a higher weightage to such asset in their portfolio and without considering its usefulness in the overall asset allocation, they continue to hold on to the asset.

In the above example, an investor had inherited a flat worth Rs 3cr from his grandfather; continuing to hold on to the flat changed its asset allocation significantly.

Investors should treat the inherited investment under one portfolio and “gradually” change the asset allocation as per his/her risk profile. Investors should ask **“Would they make the same investment with new money today?”**



Asset Allocation is Key to Financial Success

- Asset Allocation helps overcome emotional attachment to inherited assets
- Each asset class has a different Return-Risk-Liquidity profile
- Diversification is needed to achieve optimal balance between rewards and risks
- Asset allocation decision is the most important factor for long-term wealth building
- There is no “one size fits all” formula for asset allocation. One needs to take professional help during this important step of financial planning.

Availability Bias

is a mental shortcut that

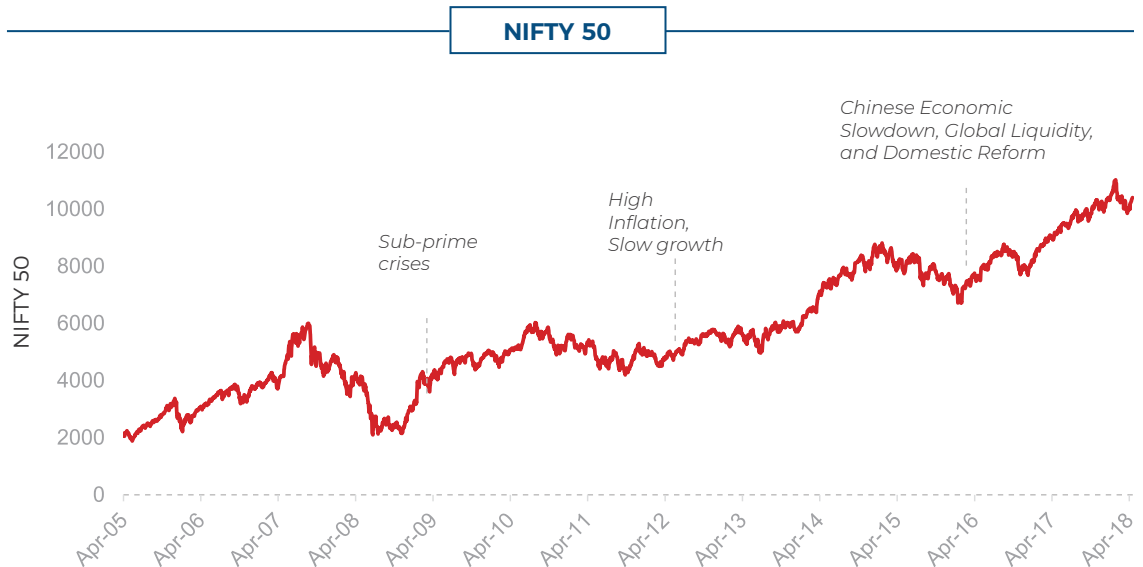
- relies heavily on information that is easily available to the investor or
- places undue emphasis on immediate examples that come to mind when evaluating a decision

Availability bias

Availability bias is the human tendency to think of events that come readily to mind; thus making such events more representative than is actually the case. Naturally, things that are most memorable can be brought to mind most quickly. People tend to remember vivid events like plane crashes and lottery wins, leading some of us to overestimate the likelihood that our plane will crash or, more optimistically -- but equally erroneously -- that we will win the lottery.

A study by Karlsson, Loewenstein, and Ariely (2008) showed that people are more likely to purchase insurance to protect themselves after experiencing a natural disaster than they are to purchase insurance before such a disaster happens.

Similarly, in investments, negative events that have led to severe market corrections are always at the top of investor's mind. However, investors tend to ignore market performance post the sharp correction. Few examples of such events - DoT com burst, 2004 crash after formation of new Government, Global Financial Crisis, Greece Sovereign Crisis, Chinese devaluation in 2015.



Source: MFI

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'Perceived Risk' is often higher than 'Real Risk' during such events

Availability bias

Implications of this bias

Investors tend to stay away from markets during such scenarios which leads to:



Under-diversification



Inappropriate Asset Allocation

How to deal with such bias?

We have seen a significant fall in equity markets over the past few weeks as Covid-19 has become the single-point matter of focus among investors. These are, no doubt, tough times as entire humanity is battling the virus pandemic deploying every tool at its disposal to save lives. With a significant chunk of the human population in lockdown, the global economy is expected to take a major hit, and the impact of which is being felt across global stock markets.

This is neither the first time or nor will it be the last time, the Indian stock markets are undergoing such sharp corrections. 1992, 2001 and 2008 were years in which, markets saw even sharper crashes, with underlying reasons different from one another. However, one common variable among these instances was the bounce back witnessed by market in each of these occasions over a period of time. This leads us to a question.

Do we expect Covid-19 to grab headlines one year from now like the way it is doing now?

As the virus scare alleviates over a period of time with the economy coming back to normalcy, the stock markets are also expected to stage recovery. This makes a strong case for investing in equities by spreading them over the next few months. Investors should use such events as buying opportunities and invest with a long term view.

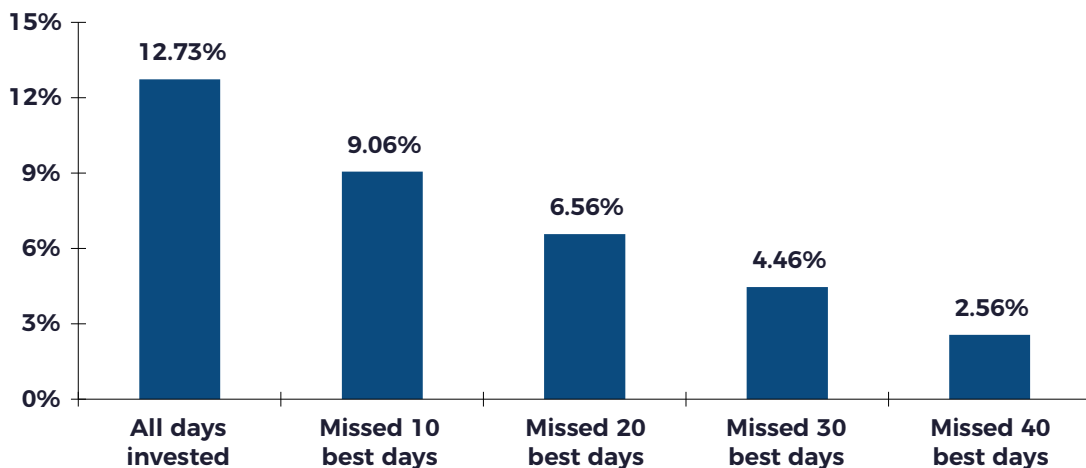
As a case in point, an investor who simply invested through SIPs throughout the ups and downs of the 2008 crisis and subsequent recovery would have performed well without undergoing much of the emotions.

Investors should consult their financial advisors on how to deal with such events.



Missed best days

■ CAGR



Daily returns from January 1, 1990 to March 31, 2020
Source: Internal calculations based on data procured from www.bseindia.com

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The above chart shows that if you had stayed fully invested in stocks (as measured by the S&P BSE Sensex) from **January 1, 1990 to March 31, 2020**, you would have earned compounded annual returns of **12.73%**.

However, if you had tried to time the ups and downs of the market, you would have risked missing out on days that registered some of the biggest gains, and the CAGR would have dropped drastically: **9.06% if you missed 10 best days, 6.56% if you missed 20 best days, 4.46% if you missed 30 best days and 2.56% if you missed 40 best days during this period.**

CAGR - Compounded Annual Growth Rate

Best days means the days on which the markets have given highest returns.
Daily returns are considered for determining best days.



Recency Bias

is the tendency to weigh recent events more heavily than earlier events.

How Recent events overtake our investment decisions?

Investors often overemphasize more recent events than those in the near or distant past. Thus, shifting focus towards the asset class in favor today. This happens as investors have the tendency to extrapolate recent experience into the future which can have disastrous consequences. The result is, it skews our view of reality and the future.

We have seen many such events in India and investors either tend to be overweight or shy away from the trending asset class. Few recent events in Indian context are mentioned below:

| Year | Event | Investors Stance |
|---------|------------------------------------|--|
| 2013 | Sharp rupee depreciation, High CAD | Risk aversion increased as investors moved to safe assets |
| 2015-18 | NBFC rally | Investors were overweight on NBFC stocks which were trading at premium valuations |
| 2017-18 | Euphoria in Mid/Small cap space | Investors were overweight on mid/small cap stocks |
| 2019 | Pessimism in debt space | Investors moved to overnight funds where the yields are lower compared to other debt funds |
| 2020 | COVID-19 | Global risk aversion |

Implications of this bias

Investors get swayed by recent events and tend to be either overweight or underweight the asset class in favor/out of favor; thus leading to inappropriate asset allocation.

The overall risk in the portfolio also increases drastically as investors often swing their portfolios to extremes during such situations with the hope that the trend will continue in future.

Recency Bias: Lane Changing doesn't work

Investors often focus only on the recent 1 year track record of returns when selecting a fund, rather than analyzing the process of investment manager. Thus, making investment decisions based upon the outcome and ignoring the process that led to that result.

| Rank | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|------|------|------|------|------|------|------|------|------|------|------|------|
| 1 | G | C | E | G | F | C | J | F | C | C | F |
| 2 | H | B | C | I | E | G | C | C | H | I | E |
| 3 | B | G | H | C | C | I | C | D | I | H | C |
| 4 | D | E | F | J | A | B | H | H | B | E | A |
| 5 | C | D | A | A | H | H | I | E | E | F | H |
| 6 | E | H | G | B | G | J | A | A | D | A | G |
| 7 | A | F | J | H | J | D | E | B | A | B | J |
| 8 | J | I | D | D | I | A | F | J | J | J | I |
| 9 | F | A | I | F | D | E | B | G | F | G | D |
| 10 | I | J | B | E | B | F | D | I | G | C | B |

Internal Computation of above table, past performance may or may not be sustained in the future.

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The above chart depicts the ranking of the funds over the past 10 years; it can be observed that chasing the best performing fund of a particular year does not work in the long run.

Recency Bias: Lane Changing doesn't work

How to deal with such bias?

Investors should follow the advice of a professional, should not invest directly and should have an asset allocation strategy.

Investors should not get swayed away by the past returns and should ideally look at risk statistics, the investment process, the number of securities purchased and other fundamental factors when selecting an investment manager.

Investors should follow a portfolio approach and diversify across various investments.

investment process, the number of securities purchased and other fundamental factors when selecting an investment manager.

“

The illusion that we understand the past fosters overconfidence in our ability to predict the future.

- Daniel Kahneman

”



Unable to Bring Discipline in Investing

Spending habits can impact long term wealth

Studies have shown that spending tends to be greater when consumers use credit cards rather than cash, due in part to certain behavioral cues that using credit cards may create. One effect is that a credit card “decouples” the act of purchasing from the consumer’s wealth – “get it now, pay later.” – **study by RA Feinberg (1986)**

People do not act in their best long-term interest because they lack self control. Often people prefer high standards of living in the present, rather than saving for retirement. People who suffer from self-control bias often spend today and sacrifice their retirement, and do not invest in equities or take part in the benefits of rupee-cost averaging.

Recent trend in India’s household savings and household debt also confirms such behavior where investors prefer to live in the present, rather than securing their future.

| | Household savings as a % of GDP | Household Debt as a % of GDP |
|---------|---------------------------------|------------------------------|
| 2014-15 | 19.2 | 15 |
| 2015-16 | 17.6 | 16 |
| 2016-17 | 16.9 | 17 |
| 2017-18 | 17.0 | 18 |

Source: RBI

The “**save more tomorrow program**” is a classic example to counter such behavior which automatically increased savings rates for plan participants each year. (80% remained in the plan through three pay raises). This is a great way to counteract the natural tendency of people who suffer from self-control bias.

Solution?

Again the magic tool - SIP

- The concept of SIP is in a way similar to “Save More Tomorrow” Campaign
- By enrolling into an SIP, you make a commitment to save a particular amount of money every month for the next ‘n’ number of months
- The amount that is mentally earmarked for SIP helps us to avoid expenses on extravagant / lavish needs, thereby bringing in discipline
- SIP Top up can also be used a tool to overcome this bias – SIP Top up allows you to increase the amount of the SIP Installment by a fixed amount at pre-defined intervals. This facility enhances the flexibility of the investor to invest higher amounts during the tenure of the SIP



Is Short Term Thinking a Disease?

What Makes Us Think Short Term?

Professor Walter Mischel, then a professor at Stanford University, conducted one of psychology's classic behavioral experiments on deferred gratification named "marshmallow test". Deferred gratification refers to an individual's ability to wait in order to achieve a desired object or outcome. The study concluded that individuals that tend to delay gratification were less likely to show extreme aggression and less likely to over-react if they became anxious.

Similar analogy can be drawn to the field of investments wherein investors over react to short term market movements and tend to redeem their investments for short term gains.

Your investment cost is Rs 100. Which of the below would you prefer?

**RS 108
AFTER
1 YEAR**

**RS 200
AFTER
8 YEARS**

Investors who prefer instant gratification would tend to sell their investments for short term gains and choose option 1; this will ideally lead to improper asset allocation and will shift the investors focus from the goal for which the investment was made.

What Makes Us Think Short Term?

XYZ Fund

Illustration of XYZ Fund- Rs.10,000 invested on inception date

Investors would have been tempted to book profits at various intervals (at points highted in the chart). However, if one had remained invested till date, Rs.10,000 invested in the fund would have grown to Rs.5 lakhs.



The above table is shown for illustrative purpose to explain the concept.

Implications of this bias

Investors tend to invest with a short term view and focus shifts away from the goal for which investment was made

How to deal with such bias?

Investors should do goal-based investing. Invest in equities with a long term view. For short to medium term goals, consider debt funds.

| To Conclude

For all its limitless powers of imagination, miraculous artistic capabilities, never-ending endeavor for excellence and boundless achievements over the millennia, the 'human mind' is neither free from its delusions nor is it resistant to making embarrassing misjudgments. Our mind occasionally lets us down when it comes to data taking and analyzing in a complex world – the world of investing is no different.

When it comes to decision making, whether it is choosing a word in a game of Scrabble, zeroing-in on next holiday destination or whether to invest in a stock, we try our best to rely on facts and data, while topping it up with a human touch in the form of our best judgments, hunches, intuitions and insights. It is undeniable that emotions like greed and fear are involved when an individual investor makes decisions as represented by inflows at the time of market highs and outflows during a market fall.

Even great investing minds give in to emotions. Harry Markowitz, father of Modern Portfolio Theory and a Nobel Prize winner in Economic Sciences, was once asked as to what was the asset allocation in his personal portfolio. He famously replied "It's a 50:50 split between equities and bonds as I visualized my grief if the stock market went way up and I wasn't in it—or if it went way down and I was completely in it. My intention was to minimize my future regret". This is an example of one of the best ever minds in the world of finance admitting and accepting human fallacies.

Thankfully the solutions to overcome these emotional reactions are astonishingly simple. The key messages of this work as detailed in the earlier pages is to embrace the basics like focus on asset allocation, investing through SIPs, investing with a goal and to take help of an advisor. It is exactly these 'sticking to the basics' approach that can shield us from the urge to act frequently, to free ourselves from emotions while making decisions and help us stay focused on the path of long-term wealth creation.

Disclaimer

Documentary Requirements and Procedures

This is a compilation of key aspects relating to the procedures/documentary requirement(s) with respect to the following:

Know Your Customer

To invest in the schemes of Mutual Fund (MF), an investor needs to be compliant with the KYC (Know Your Customer) norms and the procedure is -> Fill the Common KYC (CKYC) application form by referring to the instructions printed overleaf.

Enclose self-certified copies of both proof of identity and address. For Proof of Identity, submit any one document - PAN/ passport / voter ID/ driving license/ Aadhaar / NREGA job card/ any other document notified by central government. Proof of address, submit any one document which is same as the proof of identity, except for PAN (since this document does not specify the address). If your permanent address is different from the correspondence address, then you need to submit proof for both the addresses. Documents Attestation - By any one from the authorized officials as mentioned under instructions printed on the CKYC application form. PAN Exempt Investor Category (PEKRN) - Refers to investments (including SIPs) in MF schemes up to INR 50,000/- per investor per year per Mutual Fund. This set of investors need to submit alternate proof of identity in lieu of PAN. In Person Verification (IPV) - This is a mandatory requirement and can be done by the list of officials mentioned in the instructions printed overleaf on the CKYC application form. Please submit the completed CKYC application form along with supporting documents at any of the point of acceptance like offices of the Mutual Fund/ Registrar, etc.

Modification to existing details like address/ contact details/ name etc. in KYC records - For any modifications to be done to the existing KYC details, the process remains same as mentioned above, except that only the details to be changed needs to be mentioned on the form along with PAN/ PEKRN and submitted with the relevant proofs.

Modification to your existing details like contact details/ name/ tax status/ bank details/ nomination/ FATCA etc in Fund House records - Please visit the website of the respective Fund House to understand the procedure to update the details (if published) OR reach out to the customer service team of the respective Fund House.

Unclaimed or returned undelivered dividend/ redemption - If there are unclaimed dividend / redemption pertaining to your investments (can be ascertained by referring to the MF account statement OR by visiting the website of the respective Fund House), please reach out to the customer service team of the respective Fund House.

Disclaimer

Consolidated account statement issued on monthly/ half-yearly basis/ account statement issued by the Fund House etc - We urge you to regularly check these statements to ascertain that all details updated are correct.

Update of PAN: As per the directives issued by SEBI from time to time, it is mandatory for all investors to update the Permanent Account Number (PAN) (unless exempt from furnishing PAN) in their mutual fund. All joint holders are required to update their PAN in their folio. In case of folios of minors, where the minor does not possess a PAN, it is mandatory to update the PAN of the father, mother or court appointed legal guardian of the minor.

As a part of Go Green initiative of SEBI, investors are requested to keep the latest email id and mobile no. updated with the respective fund house.

Dealing with registered Mutual Funds

Investors are urged to deal with registered Mutual Funds only, details of which can be verified on the SEBI website (www.sebi.gov.in) under Intermediaries/ Market Infrastructure Institutions.

Redressal of Complaints

If you have any queries, grievances or complaints pertaining to your investments, you may approach the respective Fund House through various avenues published on their website. If you are not satisfied with the responses provided by the Fund House, you may then register your complaint on SCORES (Sebi COmplaints REDress System) portal provided by SEBI for which the link is -> <https://scores.gov.in>

Disclaimer

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