



Irish Life

# Investors Behaving Badly & The Value of Professional Advice

October 2007

For Financial Advisers only

*Rewarding Investments*



Irish Life



# INVESTORS BEHAVING BADLY

## The Impact of Uncertain Markets

For Financial Advisers only

*Rewarding Investments*

Why do retail investors.....



Irish Life

**Buy High.....**

**.....Sell Low**



For Financial Advisers only

*Rewarding Investments*

# BEHAVIOURAL FINANCE Vs EFFICIENT THEORY



**Markets efficient over long term**

**But, only partly efficient in short term**

**Anomalies occur**  
– based on psychological factors

# ASSET PRICE 'BUBBLES'



Irish Life



For Financial Advisers only

*Rewarding Investments*

# BUBBLES REPEAT THROUGH HISTORY



Irish Life



**SOUTH SEA  
COMPANY**



**DUTCH  
TULIP  
BULB**



**JAPANESE  
PROPERTY  
PRICES**



**INTERNET  
STOCKS**

For Financial Advisers only

*Rewarding Investments*



# WHY DON'T INVESTORS LEARN?



*'I can predict the motion  
of the planets...*

*...but not the madness  
of crowds'.*

*Sir Isaac Newton*



Irish Life

# THE INFLUENCE OF PSYCHOLOGICAL FACTORS



**HEURISTIC BIAS**

**FRAME  
DEPENDENCE**

**Trial and error**

Misjudgements based on unconscious assumption

How internal and external factors impact perception and decision making

For Financial Advisers only

*Rewarding Investments*



# FRAME DEPENDENCE

€1000 on **Red** 12

For Financial Advisers only

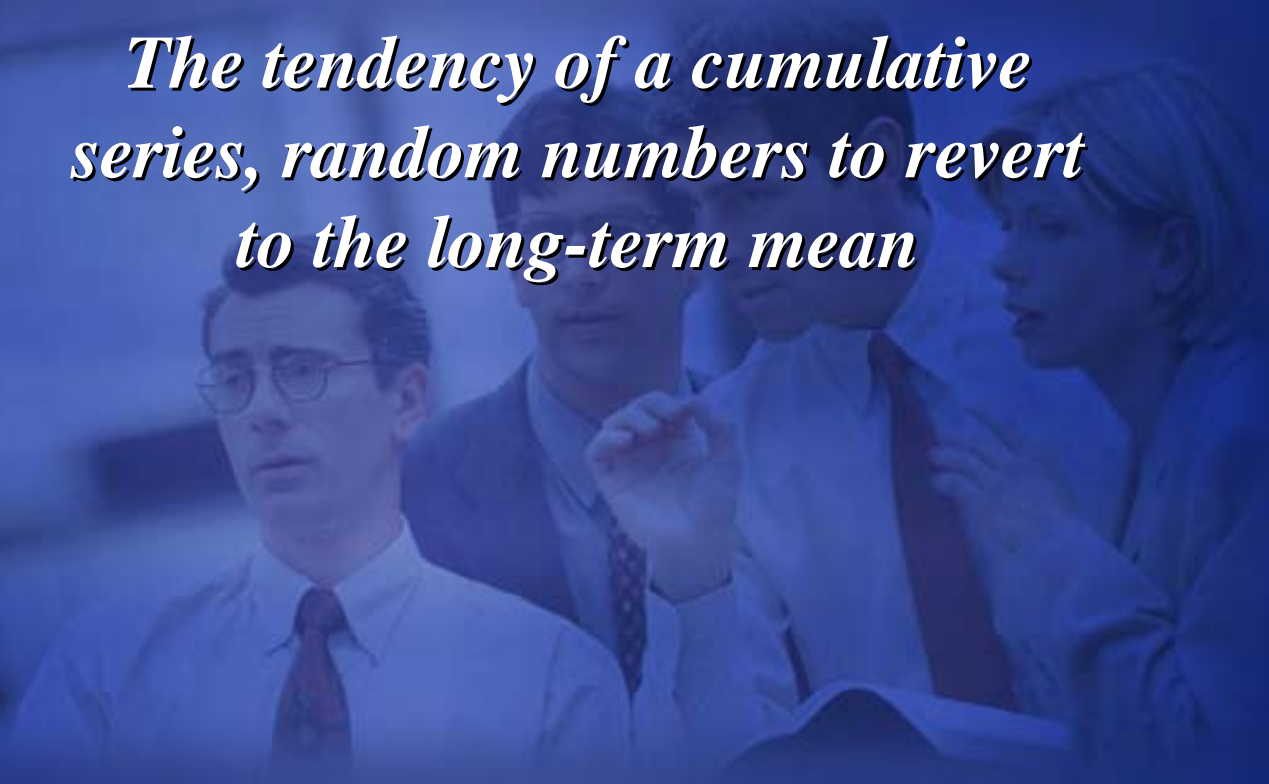
*Rewarding Investments*

# REVERSION TO THE MEAN



Irish Life

*The tendency of a cumulative series, random numbers to revert to the long-term mean*



For Financial Advisers only

Rewarding Investments

# GAMBLERS FALLACY



Irish Life

**50/50**

1



2



3



4



5



For Financial Advisers only

*Rewarding Investments*

# AVAILABILITY BIAS



Irish Life



*frequent, recent or more memorable information disproportionately influences investors, who subconsciously hold its occurrence to be representative.*

For Financial Advisers only

Rewarding Investments

# SALIENCY

*The recency, frequency or emotional impact of an event or experience*



More salient experiences exert a stronger behavioural influence





Irish Life

# So what does all this mean for investors?



For Financial Advisers only

*Rewarding Investments*

# SETTING OBJECTIVES



**OVER ESTIMATE RETURNS**

**UNDER ESTIMATE CONTRIBUTIONS**

**OVERLY CAUTIOUS ON RISK**



Irish Life

# Stockmarket too risky



For Financial Advisers only

*Rewarding Investments*

# WHAT IS RISK



“How good can  
this get ?”

“How bad can  
things get ?”

**UPSIDE  
POTENTIAL**

**SECURITY**

# FEAR OF LOSS

**€100 LOSS  $\neq$  €100 GAIN**

**€100 LOSS = €250 GAIN**

**Asymmetric Relationship**



# LOSS AVERSION



Irish Life

**Investor behaviour  
motivated by a  
subconscious fear of loss**



**For Financial Advisers only**

*Rewarding Investments*

# REGRET

**Pain associated with  
responsibility for a loss**

**PAIN  
OF  
REGRET**

**PAIN  
OF  
LOSS**

# INVESTOR OPTIONS

## STOP INVESTING



- Eliminate future regret
- Miss future gains
- Opportunity cost

## SIT TIGHT



- Pain of loss
- Less pain of regret

# THE DIVERSIFIED PORTFOLIO

## Tangible Benefits

- Balance of Assets & Regions
- Less sensitive to styles & trends
- Lower volatility

## Psychological Benefits

- Emotional value greater than underlying components
- Represents adviser expertise

# CONCLUSIONS



Irish Life



**Most investors are  
their own worst  
enemy**

**Advisers protect  
investors from  
themselves**

**For Financial Advisers only**

*Rewarding Investments*



- *Irish Life Assurance plc is regulated by the Financial Regulator. This presentation is intended for Financial Advisers only*
- *Opinions: Any opinions expressed may be subject to change without notice. We are not soliciting or recommending any action based on this material.*
- *Past performance is not a reliable guide to future performance. The value of investments may go down as well as up.*

*Fidelity Investments & Irish Life have combined their investment knowledge and expertise to produce this presentation.*