Stocks to Riches Parag Parikh (insights on investor behaviour)

- Chapter1:What is investing?
  - Life is all about doing something to reap benefits out of it
- Investment Products
  - Stocks
  - Bonds
  - Mutual funds
  - Real estate
  - Insurance
  - Gold silver(precious metals)
- Investor classification
  - Stock trader
    - Who uses the stock and procedure of trading
  - Long term investor
    - Who uses stock buying and holding long
  - Short seller
    - Who uses stock for selling and buying back
  - Real estate speculator
    - Who uses real estate and uses procedure of speculation
  - A collector of coins
    - Buys and holds the product of rare coins
  - Commodity future trader
    - Adopts the procedure of future markets to trade commodities
  - Stock option trader
    - Adopts the procedure of hedging the stocks
  - A day trader
    - Uses stocks and procedure of speculation
  - A saver
    - wants to hold over a long term by putting money in the bank
- Investment procedures
  - Going long
    - Buy an investment product and hold it
  - Going short
    - Sell an investment product and then buy it
  - Trading
    - Buy and sell in investment
- Chapter-2: Investment strategy (investment and speculation)
  - Cash flow
    - Company's fundamentals
    - Inherent strength
    - Sustainability of the business
    - Robustness of the business model
    - Competitive market position
    - Core competencies
  - Capital gains
    - Stock goes up and costumer sells it at a profit is capital gain
- The law of the farm
  - You reap what you sow but the crop is also subjected to the changing seasons
- A good strategy
  - Understand the difference between investing speculating
  - Do not speculate or assume without the right knowledge
  - Do not speculate beyond the capacity to take the loss
- Chapter 11:Why must one invest
  - Learning the money game
    - Whats an asset ?
    - Whats an liability
  - Cash flow of the middle class
    - Middle class people are the active borrowers
    - They make little effort to create assets
  - Cash flow of the rich
    - They creates the assets
    - They invest in stocks, bonds, real estate
    - To become rich you must have a passion for money and become financially literate
  - Four ways of making money
    - Employee cash flow quadrant :They work for somebody and earn a salary as employees
    - Self employees cashflow quadrant: Professionals like doctors , lawyers, architects, who are self employeed
    - Business cash flow quadrant: They are the ones who own business
    - Investors cash flow quadrant: investors whose income comes from investment
- Chapter 10:The stock market bubble
  - Systems thinking
    - Reinforcing Feedback
      - When changes in the whole system return to amplify the original change which amplifies more change
    - Balancing feedback
      - When changes in the whole system return to oppose the original change to dampen the effect
  - The psychology of stock market participants
    - Government
      - Needs booming market as it helps economy
    - Regulator
      - Appointed by the government to regulate the market who also like a rising market
    - Stock exchanges
      - Facilitate stock transactions during boom periods, incomes
    - Brokers
      - Bull markets is good for brokers
    - Banks
      - Their business increases with soaring stock markets
    - Companies
      - Rising market led to higher stock prices and helps companies to gain more capitals
    - Mutual funds
      - Rising market attract more investors
    - Media
      - Increase in investors leads to increased advertisement revenue
    - Investors
      - The lure of quick money in bull market draws investors
    - Operetors
      - He is the king-makers who uses his knowledge to win over investors, brokers and company management
  - Making the Bubble
    - Stock price
      - The fulcrum of the stock market is the stock price
    - The deal
      - The management gives the operator some stock at low price and a predetermined amount to rig the stock
    - Circular trading
      - Step 1: The operator has own bond of brokers who sells and buys stocks among each other
      - Step 2: If the stock value has risen saliency heuristic is at work
      - Step3:More stock market participants enter the fray. This further enhances the credibility of stocks
    - The bubble bursts
      - The stock price looses momentum and stock price falls
- Chapter 9 Mutual Funds: An idea whos time has gone
  - The beginnings
    - The industry is to channel the savings of a vast number of small investors into the market
  - The rules o the game
    - Long term investment strategy
    - Investor friendly: exit in 24 hours
    - Professional fund managers with good expertise
    - Backed by string research analysts
  - The paradox
    - on one hand it talks about long term investment philosophy and in other it gives option to the investor to exit whenever h wants
  - Fund manager's behaviour
    - Their decisions are influenced by herd mentality
  - Destructive envionrment
    - The current volatility and pressure on the fund managers they have became weekly or rather day traders , there is no mutual fund concept left
  - A profession or a business
    - The concept of mutual fund has changes the money management and fund managers to a business
  - A solution
    - Close ended mutual funds should be the best option for long term investor
  - The future of open ended MF
    - The savings of million investors can not be subjected to abuse in an industry that encourages speculation
  - A bold vision
    - The portfolio manager can be in direct contact with the investor and would be responsible of wrongdoings
- Chapter 8 :Mental heuristics
  - Heuristic Bias
    - People develop general principles as they find out things for themsleves
    - People rely on heuristics to draw inferences from available information
    - People are susceptible to error as the heuristics they user are not perfect
    - People commit errors in particular situatons
  - Availability heuristic
  - Representative heuristic
  - Saliency heuristic
  - overconfidence
  - Herd mentality
  - Anchoring and adjustment
  - Size bias
  - Pattern recognition
- Chapter7:Mental accounting
  - Mental accounting is directly corelated to emotional state
    - Earned income vs gifted income
    - Quantity of the money in question
    - Large purchase vs small purchase
    - Cash vs credit cards
    - scared money
- Chapter 6:Decision Paralysis and the endowment effect
  - Taking decisions Reasons for not taking decisions
    - Fear of going wrong
    - The possibility of losing
    - To avoid looking folish
    - unwillingness to take risks
  - Plan of action
    - Deciding not to decide is also a decision
    - Consider the opportunity costs
    - Put yourself in autopilot
    - Change your frame of reference
    - Dont get married to your stocks
    - understand there is no free lunch
    - Learn to apply the dale carnegie principle on worry
- Chapter5 : Loss Aversion and Sunk cost Fallacy
  - Loss aversion: Fear of loosing
    - Impact of Loss aversion
      - Investors tend to prefer fixed income investment
      - Investors tend to take their profits too early
      - Investors take more risks when threatened with a loss
      - Investors tend o hold on to losers and sell winners
      - Tax aversion
  - Sunk cost fallacy : Inability to forget money already spent
    - You increase your commitment to justify your past actions because your ego is tied with the commitment Impact of sunk cost fallacy
      - Averaging cost of purchase
      - Spending on repairs
      - Government spending on unviable projects
  - Understand weather you are a victim of loss aversion and sunk cost fallacy?
    - Do you prefer fixed income over tocks ?
    - Are you tempted to move out o the market when prices fall?
    - Does your portfolio consist of f few winners followed by long list of losers?
    - Do you sell your winners first and hold on to losers?
    - Do you make your current spending decisions based on your past spending?
  - How to make wiser commitments ?
    - check your appetite for loss
    - Diversity within asset classes and across assets
    - Total port folio vision
    - Let bygones by bygones
    - Reframe losses as gains
    - Segregate gains and integrate losses
      - Weber's law :pain of two moderately bad experiences will typically exceed that pain of experiencing it both at one time
    - Pay less attention to your investments
- Chapter4:Introduction to behavioral Finance
  - Emotions change paradigms
    - This is where anthropology meets economics and psychology meets finance
    - Human beings not only makes decision with their mind also with hearts
    - Success in investing does not corelate with IQ once you are above the level of 25.Once you have ordinary intelligence. What you need is the temperament to control the urges that get other people in trouble for investing -- Warren buffet
  - Classical economic theory and Behavioral economic theory
    - The classical economic theory talks about efficiency of the market and people making rational decisions
    - Behavioral finance seek to bridge the gap between classical economics and psychology and explains people behavior
  - Behavioural finance explains the questions
    - Holding on to stocks that are crashing
    - Selling stocks that re raising
    - Ridiculously overvalue and undervalue stocks
    - Jump in late and buy stocks that have raises in rally just before the price declines
    - Take desperate risks and gamble wildly when stock falls
    - Avoid taking the reasonable risks of buying stocks unless there is an absolutely assured profit
    - never find the right price to buy and sell stock
    - Prefer fixed income over stocks
    - Buy because others are buying and sell because others are selling
  - Three sources of alpha
    - Exploit Information(traditional managers)
    - Better Model(quantitive managers)
      - Procedures to process information
    - Exploit behavior(Behavioral manager)
      - Mispriced securities because of behavioral factors
- Chapter3:Three ways of investing
  - The intellectually difficult path
    - warren buffet, chalie munger
    - This path taken by people who has profound understanding of market
    - Patience is the virtue
  - the emotionally difficult path
    - This too is based on the long term approach
    - Patience focuses on compounding investor's money in a long term
    - It requires and understanding of how out emotions guide our decision making
  - The physically difficult path
    - People finding next best opportunity to make money
    - They constantly check the price of the stocks every moment
    - Make decission based on rumors