Keep a check on your emotions when you decide to invest - Neesa Moodley - Personal Finance **2007/05/18**

Richard Branson has a knack for making money. At the April acsis/Personal Finance Financial Planning Club presentations, Prof Zak Nel and Gerda van der Linde of the SA Institute of Behavioral Finance spoke about factors influencing financial behaviour.

The core of behavioural finance is how irrational or illogical factors affect your financial decision making. You need to be aware of these irrational or emotional mistakes and be able to identify when you are about to make them so that you can take remedial action, Zak Nel says.

Gerda van der Linde says some participants in the financial services field believe that in order to comply with the Financial Advisory and Intermediary Services (FAIS) Act, the only requirements are that they fill in a form, tick the relevant boxes, do a risk analysis and make the correct investment choice.

It is not this simple. To avoid misunderstanding your investment needs and decisions, your financial adviser needs to consider your psychology, she says.

Key influences
Your cognitive and emotional state and social environment influence both the way you think and your personality, Van der Linde says. Behavioural finance is not about how you should act but rather about how you do act. Your actions are not always rational. She explains that the brain is wired like a computer and you rely on certain triggers from your environment to access certain information.

First, you make your decisions either intuitively or by logic and reasoning. In daily activity, most decisions are made intuitively as you do not stop and think before every action that you take.

However, using logic does not always lead you to the correct decision. You need experience and knowledge as well as time to make a good decision. For example, if you are in a good mood, you tend to make less rational decisions that are based on the "high" that you feel.

Other emotions such as anger, pride, regret, joy and envy can, therefore, be a major factor when you make your financial decisions.

Van der Linde advises that you train yourself to rely less on your emotions when you make financial decisions.

"However, this is not easy as your emotions serve to protect your self-esteem and emotional well-being," Van der Linde warns.

Social influences such as peer- group pressure can lead you to follow advice from "investment conversations", she says.

As an example of this, she says many Afrikaners made popular social investments in companies such as Rembrandt in the 1960s.

Today, trade unions can similarly expect their members to invest in certain approved funds, such as those that are black-owned or empowerment-friendly.

The golden rule when you are listening to "investment conversations" around the braai or in other casual environments is that if people mention unrealistic returns of 30 percent or more, you should avoid following that advice.

Such returns are generally too good to be true and could lead to disappointment or even financial ruin at a later stage, she says.

Money personalities
According to Nel, there are 16 different money personalities, based on eight core characteristics:
• The extrovert (E) relaxes in the company of others.
• The introvert (I) has fewer but deeper friendships.

• Sensing (S) people are also known as "here and now" people - they use their ears, touch and vision to gather information and examine the details.
• Intuitive (N) people have a sixth sense and rely more on hunches, speculation and inspiration to reach a decision.
• Thinking (T) people think through all the consequences.
• Feelers (F) make decisions based on how they feel at the time.
• Judging (J) types are goal orientated with specific plans in mind.
• Perceiving (P) types simply go with the flow.

Personality types will reflect four dominant core characteristics, the combinations of which Nel has narrowed down to 16 money personalities. Although all personality types have the potential to make good decisions, different types tend to make different kinds of financial decisions.

Your personality type also affects your relationship with your financial adviser, Nel says. For example, someone with the characteristics ISTJ would be extremely careful and could drive his or her financial advisor crazy, Nel says. This personality type takes time to consider potential investments. They probably take the longest of all the personality types to make their choices but once the decision is reached, it is usually a good one and they stick to it.

On the other hand, a person with the characteristics ESTJ would generally be a high achiever in the work environment. These are the people with the most money to invest, particularly later in their careers, and they are likely to want to manage their own portfolio so that they have a feeling of control.

People with the characteristics ENFP tend to be overconfident and to overestimate themselves. They can also be quite impulsive in the choices they make.

In the current financial environment, consumers are faced with a wealth of legislative changes, and a vast amount of information is available. Some of these changes include the FAIS Act, the National Credit Act, the Financial Sector Charter and the Pension Funds Act.

Financial advisers are under pressure to know the new rules of the game, while investors are faced with information overload.

These combined pressures have created uncertainty in the market, with some consumers being confused about their rights and how they are affected.

This leads to more mistakes being made. Van der Linde says this, combined with time constraints and strong emotions, can easily lead to irrational decisions that may result in financial losses.

Common errors
There are certain systematic mistakes that people make when they make decisions about money. You can protect yourself by identifying them and staying away from emotional triggers. Nel and Van der Linde offer the following advice:

• Don`t make an investment decision on the same day a significant event takes place in your life, which could cause you to become emotional.

• Take the information out of the context in which it is presented, as the presentation can create illusions. A salesperson will seldom tell you what the product is not. They put the product in a narrow frame by telling you only about its benefits. However, your decision could change if the frame changes and you gain more information.

• Realise the power of marketing. When your financial adviser advises you, make sure he or she knows what your frame of reference is. This determines how you approach problems and investment products. If the financial adviser understands your needs, this reduces the chance of a misunderstanding occurring or of your money being placed in an unsuitable investment.

An example of marketing power would be if a reader assumes that because a company has won two Raging Bull awards, its funds would be good investments. This is not always the case.

• People become very emotional about losing and this is known as risk aversion. They can hold on

to a losing investment simply to try to break even. By holding on to the losing investment, they avoid regret but they also do not assume responsibility for their mistake.

• Be aware of your mental accounting habits. People treat hard-earned money conservatively while they tend to treat "easy" money or windfalls more recklessly.

• A common cognitive error is that of anchoring, where investors become fixed on ideas. Often an investment product is sold with a projection value that is based on factors at the time of sale (such as inflation). The projected value is based on the assumption that you will not disinvest ahead of schedule. Investors can become fixed on this projected value and when the investment eventually pays out, this can lead to disappointment if factors, such as interest rates, have changed significantly. An example of this would be a person who bought a property for R400 000 and then an estate agent valued the property at R1.5 million at a later stage. Several months after the valuation, the person receives an offer to purchase for R1.2 million. The typical reaction would be a reluctance to accept the offer despite the fact that the profit would be considerable.

In this case, the seller is fixated on the figure of R1.5 million.

You would be better off if you did not anchor on historic prices, perceptions or historic values