Psychology and Finance – Sanjoy Bhattacharya

Financial Literacy

April 24, 2021

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What Really Matters:
An aide-memoire

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- Save more, control your needs and stay flexible.
- Patience, compounding.
- Greed and fear. Goals and time horizons. Bubbles and investing. Infosys in Q12000. Understand what you want and when.
- Financial outcomes are driven by luck, independent of intelligence and effort.
- An ounce of character is worth far more than a pound of knowledge. Behaviour matters.
- Math (rules, fixed relationships) vs psychology (emotions, risk & uncertainty).
- Experience precedes understanding.
- Lottery tickets, housing loans, credit cards, index funds.

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- Luck vs skill vs risk. Graham, Zuckerberg and Yahoo, Yahoo and Microsoft, John D Rockefeller.
- Avoid studying extreme examples, focus on the commonplace and frequently repeated patterns.
- “Success is a lousy teacher. It seduces smart people into thinking they can’t lose” - Bill Gates
- “There is no reason to risk what you have and need for what you don’t have and don’t need” - Warren Buffett
- The hedonic treadmill.
- Social comparison. Wealth vs envy.
- “Enough is realizing that the opposite – an insatiable appetite for more – will push you to the point of regret”. – Morgan Housel
- What does it take to become truly wealthy? Discipline and consistency.

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- Staying wealthy? Not making a huge mistake/survival. Important to recognize the value of frugality, self-doubt and humility.

- Tails matter massively. Venture capital, Apple iPhone, pilots' careers (hours and hours of boredom punctuated by moments of sheer terror).

- "It's not whether you're right or wrong that's important – but how much money you make when you're right and how much you lose when you're wrong" - George Soros

- Having a sense of purpose and being who you are, not what others would like you to be.

- Harry Markowitz and the 50/50 portfolio. John Bogle and hedge funds. David Fisher and selling stocks. Being comfortable allows you to stay the course!

- Outlier events, structural change. The Intelligent Investor. "The correct lesson to learn from surprises is that the world is surprising" - Daniel Kahneman

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- Understanding the importance of the room for error. Blackjack, bridge. Learning to think in a probabilistic manner. Margin of safety and uncertainty, randomness, volatility. Enhancing survivorship. Holding cash. Optimism bias and leverage.

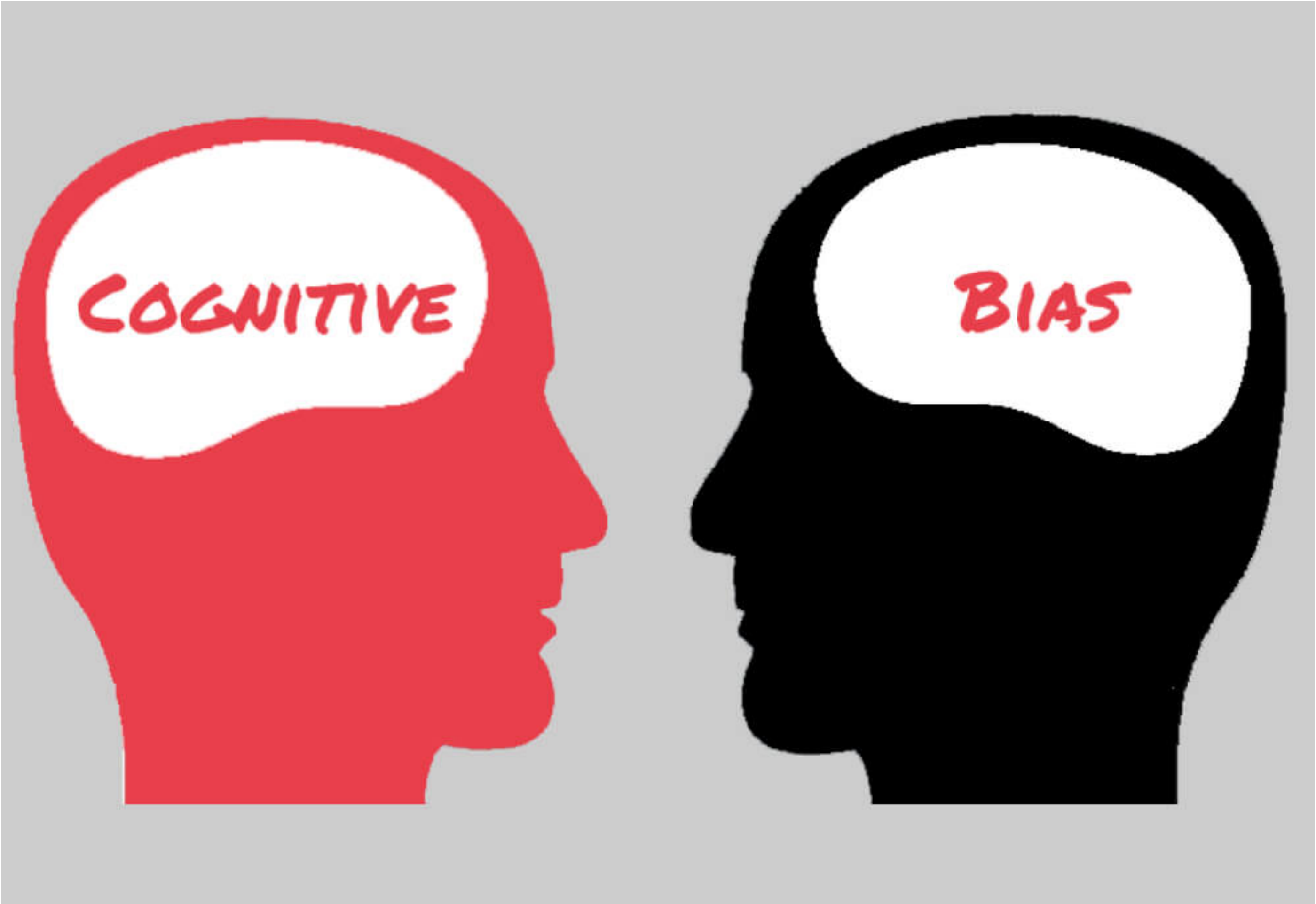
- Dealing with the unknown and unanticipated. Contingency/back-up plans. The best personal finance contingency plan?

- The End of History Illusion and future regret. Strive for balance and endurance. Accept the reality and move on quickly.

- No such thing as a free lunch. Fund returns and investor returns. The problem of buying a new car. The real price of success. Fees and fines.

- Optimism vs pessimism. Loss aversion. Ubiquity. Extrapolation vs adaptation. Growth is driven by compounding, destruction by a single point of failure. Stephen Hawking and expectation vs outcome.

- Know that you don't know. Hindsight bias. Overconfidence. The myth of forecasting.



Conclusions

1. Save, defer gratification.
2. Understand the role of risk and luck. Remember to stay humble when things go well and compassionate when things go wrong. Focus on what you really understand and control.
3. Think long-term.
4. Choose sleeping well over eating well.
5. The real benefit of being rich is the freedom to live life on your terms.
6. Survival is the key. Margin of safety is what will allow the magic of compounding to deliver results.
7. Surprises are inevitable. Mentally, come to terms in dealing with surprises.
8. Understand who you are. Only do what makes sense to you.
9. Try asking the right questions. Remember there are no exact, right answers.
10. Strive to be decent and modest. Character counts.

Thank You

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