

Market & Portfolio Update – October 2017

The Irrational Investor

Humans are irrational by nature - we're afraid of mice, we play the lottery, and we perceive things to be superior if they have a higher price. For years both economic and finance theory ignored this fact and instead assumed everyone acted rationally when making financial decisions. But recently there has been a new train of thought – human emotion can have an impact on financial markets as much as any other aspect of life.

One of the most common examples of irrational financial decisions is a principle called mental accounting. That's when people separate their money into different buckets based on different, subjective criteria. For example, people are more likely to spend a bonus on luxury goods whereas their regular salary is carefully budgeted. To avoid this irrational behaviour, the key thing is to remember money is fungible (or interchangeable). It has the same value no matter how it is earned, and it's intended use should be considered irrelevant of where it came from.

It's not just individual financial decisions that are prone to irrational behaviour, financial markets are affected as well. Herd behaviour is one example of this. That's when people follow others just simply because they don't want to miss out. It's the kind of behaviour that leads to bubbles occasionally forming in certain assets and is the principle behind Warren Buffet's famous quote "be fearful when others are greedy and greedy only when others are fearful".

This is also one of our key philosophies at Booster – when too many people are either overly optimistic or overly pessimistic, we are more inclined to look for opportunities to go against the herd. Subject to a careful assessment of the right timing for any changes, this philosophy can not only have a positive impact on returns but it can also add to the consistency of returns over time.

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Warren Buffet



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- ❖ Share markets continued their 2017 ascension during October, with a moderate 3% gain boosted further by the New Zealand Dollar falling 5%. For New Zealand investors, the fall in our local currency reinforces the diversification benefits of holding foreign investments, which rise in value when the currency falls.
- ❖ While exchange rate changes have featured this month, the real story driving markets is global economic growth continuing to expand all around the world. This is one of the pillars supporting global share markets' good performance since the start of the year.
- ❖ With many investors globally remaining arguably too cautious about the current economic expansion, in the vein of Warren Buffett, Booster slightly increased funds' global share investments during the month of October.