

“It’s not the bad investments that do you in, it’s the good ones.”

- Unknown

The above quote illustrates how carefully-researched and well thought-out investments and strategies can work against investors at times. Through research, investors can become committed to an idea. Frequently, they find themselves promoting their idea to others and thereby feeling a need to be consistent. I do not want to discount the importance of doing your homework, but I do want to illustrate some of the problems investors can encounter by becoming overly committed to an investment strategy. Why do investors occasionally embark on an investment strategy that, in retrospect, looks absurd? A possible problem can be traced to an investors need to be viewed by others as consistent. When a good investment clearly turns bad, I am amazed at some of the ridiculous justifications I hear to continue holding the position. These justifications range from, “I am an investor, not a speculator” to “it’s not timing, it’s time.” This dynamic does not seem to have intelligence or net-worth boundaries.

I recently found a passage from the book *INFLUENCE The Psychology of Persuasion*, by Robert B Cialdini, PH.D., that I believe is relevant for investors and that may help explain this behavior. In a university study, described in the book, it was found that people would fool themselves in an attempt to appear consistent, especially when they take a public stand. In this experiment three groups were asked to estimate the length of some lines they were shown. The first group was asked to write down and sign their names to their guesses. The second group wrote their guess down and then erased their answers. The last group made a mental guess. Additional information was then provided to demonstrate their initial guesses were incorrect. The results were clear. The group that wrote down their guess resolutely defended them even in the face of the news their initial guess was incorrect. Correspondingly, the people who wrote and then erased their guess were less willing to change their mind in face of the new information. Lastly, the group who simply made a mental guess was the most willing to change their mind to the correct answer.

Being inconsistent, or “non-committal”, is normally viewed in our society as a poor character trait. On the other hand, in the investment process it can be very valuable. Investors frequently get themselves into the psychological trap of wanting to appear consistent to others. I review lengthy research reports on particular companies or investment strategies. When the investment climate invariably changes, and their research turns out to be incorrect, it is common for these investors to endlessly defend their conclusions in the face of a large loss. This behavior, in part, might help explain how many Wall Street analysts would recommend companies to invest in during the Great NASDAQ bubble in 2000, and then see their companies slowly sink in front of their eyes while maintaining their “buy” ratings. In retrospect, many of these ideas look absurd, but it demonstrates how the desire to be viewed as consistent can influence investor’s decision. To become a successful investor you must control the urge to be viewed as consistent and be able to act prudently and objectively as facts change.

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