PERSONAL FINANCE

Retrain your mind to be wealthy and happy

By Laura du Preez

At a recent series of meetings of the **acsis**/Personal Finance Financial Planning Club, Andrew Bradley, the chief executive of financial services company acsis, spoke about the skills you need to develop if you want to invest successfully and be a happy person.

Our brains have developed a great deal over the past 50 000 years. However, these advancements haven't prepared us to make the most of the opportunities we have to be happy or wealthy, Andrew Bradley says. The good news is that you can learn the required skills and change your behaviour so that you can be both.

You may think you would be happy if you just had enough money. But there isn't a sum of money that will buy you happiness, he says.

To be happy and invest successfully, you need to tackle the enemy within - the traits that prevent you from making the right choices, Bradley says. We all have these traits, which lead us to engage in wealth-destroying behaviour.

The reasons we are not very good at working out what will make us happy are similar to those that make us poor investors, he says. They have to do with the way our brains are "wired" - our "hard-wiring".

Although we, as humans, have advanced, our "hard-wiring" is still significantly influenced by the experiences of our forefathers going back tens of thousands of years, Bradley says.

Our brains are backward-looking, pattern-seeking systems that are not suited to the likes of the stock market, which is an abstract, forward-looking pricing mechan-ism, he says.

We know the principles of successful investing: buy a diversified range of quality investments at a reasonable price and then be patient, Bradley says.

But we don't do this because of the enemy within. When we see headlines about market losses or the end of a market boom, it triggers a biological response in us to follow the herd and sell our investments, he says.

This situation is similar to being in a group of 20 people on the savannah who are suddenly approached by lion, Bradley says. Your natural instinct for survival tells you to run with the crowd, because your chances of survival are far greater than going it alone. We think the same applies to investing on the stock market, but the opposite is actually the case, he says.

Seeing what other people are doing triggers a huge desire to take action, and it is incredibly hard to resist this urge, Bradley says.

But when investors bail out of stock markets in times of crisis, money moves from weak to strong hands, he says.

The strong hands are those of people such as Warren Buffett, one of the world's most successful investors who understands that "uncertainty actually is the friend of the buyer of long-term values". Buffett buys in times of panic and does not run, Bradley says.

Manage your behaviour for happiness

To be both a successful investor and a happy person, you need to have the confidence to manage your behaviour, Bradley says.

If you want to be happy, you need to give up the idea that money buys happiness, he says.

A study by British economist Richard Layard into the relationship between wealth and happiness in the United States showed that while real income per person had steadily increased between 1945 and 2000, the percentage of the population who regarded

themselves as very happy had remained constant at about 30 percent, Bradley says.

You can increase your happiness without increasing your income, wealth or spending, he says. You can do this by doing things that give you pleasure and by giving to others without expecting anything back.

Manage your investment emotions
You can also manage your emotional reaction to your investments' performance, Bradley says.

Traditional research assumed that investors cared about gains or losses only when they were realised, he says. But more recent research shows that we also derive pleasure and pain from paper gains and losses - when an investment is up or down and you don't cash it in.

Bradley says research by Nobel prize winner Daniel Kahneman shows that we are twice as unhappy about a loss as we are happy about a similar quantum of gain.

Even when we, as investors, have long-term investment horizons, short-term fluctuations in the value of our investments can be very painful, he says.

But you can minimise the pain if you have a financial plan and stick to it, Bradley says. This involves choosing appropriate investments that will deliver what you need and then staying with them without chasing the top-performing investments or fund managers.

In the US, research by Morningstar showed that the average return from mutual funds (unit trusts) over a five-year period was 12.5 percent a year, but the average investor lost 2.2 percent a year, Bradley says. In South Africa, over a five-year period the average return from funds was 9.4 percent a year, but the average investor earned only 4.1 percent.

He says investors earn returns that are much worse than the average because they chase the best performers and usually get the timing wrong, investing just before a top performer falls from grace. Sticking to your financial game plan will help you avoid succumbing to the emotional cycle that accompanies market cycles, Bradley says.

When markets are flat, investors are complacent. When markets begin to fall, investors often engage in wishful thinking, hoping the downturn will end, he says.

As markets fall further they get progressively more concerned and finally become fearful. As the market down-cycle reaches the bottom, fearful investors capitulate and sell their investments, Bradley says.

Just around this time, markets turn and start climbing again. Initially, the investors who bailed out feel only contempt, but as markets continue to rise, they become cautious. Then the fact that they aren't invested begins to hurt their egos, Bradley says.

Finally, they become confident and have the conviction - even greed - to reinvest. This usually coincides with the top of the market before the next downturn, Brad-ley says.

If you want to stick to your investment game plan and avoid decisions based on emotion, don't just look at how your investments have performed over a particular period but take a holistic view in terms of your overall objective, Bradley says.

You should consider what you need to do to achieve your goal and examine how you are invested. Then determine the likelihood of your achieving your objectives with the strategy you are using. Maintain your focus on achieving your goals and do not get caught up in minutiae and panic, he says.

You may also need to consider setting different goals with different time horizons, and see how far you are towards meeting these goals.

Bradley quoted the case of an investor who expressed concern because his investments had fallen 5.8 percent since May this year. He had, however, been invested for some time

and over the entire period had made a gain of 240 percent.

This example, Bradley says, demonstrates the need for you to focus on your long-term returns.

You should make sure you view the information you receive about your investments and markets in the appropriate perspective. Have a good look at the longer-term perspective and then reflect on this within the short-term dynamics. Do not ignore some of the information, just keep it all in perspective, Bradley says.

To quote the words of Buffett: "To invest successfully over a lifetime does not require stratospheric IQ, unusual business insights or inside information. What is needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework."