EXCERPTS FROM LETTER TO INVESTORS

Saurabh Singal's monthly letters to the investors in the Indéa Ankam Fund have generated wide interest. Here is a sample.

Brilliantly Irrational
(Nov'09)

Tiger Woods seems to be everywhere; one cannot surf the TV channels without a reference to his car crash, transgressions and all. However, to those of us who study cognitive theory with a view to making better investment decisions, far more interesting is the thought that the brilliant Tiger Woods might be a victim of the same irrational biases as the rest of us. In a recent paper titled *Is Tiger Woods Loss Averse? Persistent Bias in the Face of Experience, Competition and High Stakes*, Devin G. Pope and Maurice E. Schweitzer suggest that even the world's best golf professionals are so concerned about avoiding losses that they play far too cautiously.

The paper is available on SSRN (http://ssrn.com/abstract=1419027); we quote from the abstract.

> *"Although experimental studies have documented systematic decision errors, many leading scholars believe that experience, competition, and large stakes will reliably extinguish biases. We test for the presence of a fundamental bias, loss aversion, in a high-stakes context: professional golfers' performance on the PGA tour. Golf provides a natural setting to test for loss aversion because golfers are rewarded for the total number of strokes they take during a tournament, yet each individual hole has a salient reference point, par. We analyze over 1.6 million putts using precise laser measurements and find evidence that even the best golfers – including Tiger Woods- show evidence of loss aversion. On average, this bias costs the best golfers over $1.2 million (each) in tournament winnings per year."*

Loss aversion, as we know, refers to people's tendency to strongly prefer avoiding losses to acquiring gains; psychologically, the impact of losses is often twice as powerful as that of similarly large gains. A pernicious variety of loss aversion called **myopic loss aversion** or **short term loss aversion** is particularly rampant in the investment management world. The situations tested in the paper is similar to that of an investment manager who is clinging on to a 15 bps month-to-date profit on the last day of the month, and is presented with a short term investment opportunity that has equal probabilities of a 50 bps gain or a 25 bps loss (which would make his returns negative for the month). One suspects that quite a few would play it safe and aim for a positive month, foregoing a favorable wager in the process.

It Was Just A Coincidence...
(Oct'09)

Coincidences always provide food for thought, and of late there have been some well publicized ones. The BBC website reports that the same set of six numbers turned up as the winning combination in two successive drawings of a Bulgarian lottery recently (http://news.bbc.co.uk/2/hi/8259801.stm). As there are ${}^{42}C_6 = 5{,}245{,}786$ ways of choosing 6 numbers from a set of 42, a casual analysis would suggest less than one chance in five million of this happening. (Given that there are many lotteries all around the world, running for several decades now, the probability of something like this occurring somewhere at sometime, is much higher than one in five million). A governmental enquiry concluded there was no evidence of fraud, and that it was just a coincidence. A smart fraudster would probably try something more subtle in any case. Even more interestingly, a record 18 people guessed all six numbers in the second drawing; each winner got the princely sum of 10,164 Leva (about eight thousand dollars). Clearly, they understand gambler's fallacy well in Bulgaria.

And just days ago, a WSJ article mentioned the even more curious coincidence of Governor Arnie's letter to the California state assembly. The first letters of the first seven rows spelt an obscenity which we will not repeat in these polite pages, except to mention that the first of these words was "for", the second, "unnecessary" – you can guess the rest or read about it on the blog of MIT's Steven T. Piantadosi (http://piantado.scripts.mit.edu/wordpress/?p=30), who computed the probability of such a coincidence at one in a trillion.

Don't Be Fidgety!
(Sep'09)

Sports and games often teach the observer a thing or two about psychology (and investing). Recently we came across a delightful paper which illustrates how a well known effect in economic psychology can teach goalkeepers how to improve their performance in that most challenging of tasks – that of saving penalty kicks. (*Action Bias Among Elite Soccer Goalkeepers: The Case of Penalty Kicks.* Ofez Azar and Bar-Eli, M., Azar, O.H., Ritov, I. & Keidar-Levin, Y., Journal of Economic Psychology, 28, pp 606-621.) The authors noticed that goalkeepers save a lot more penalty kicks by staying put in the centre of the goal than jumping either to the left or right.

The researchers concluded that this might be a reverse of the "inaction effect" or "omission bias". Goalkeepers seemed to feel greater regret if they let the goal be scored, when they stood in the centre. If they jumped and yet could not save the goal, they had the consolation of having tried their best. As in sports, so in trading. Guardians of capital could probably do better by being less fidgety, staying balanced in their approach and not diving helter-skelter into the most recent fads.

Depression Babies
(Aug'09)

We chanced upon a very interesting academic paper recently by team of Berkeley and Stanford economists – *Depression Babies: Do Macroeconomic Experiences Affect Risk-Taking?* (Malmendier & Nagel, 2009). We quote from the paper:

> *Does the personal experience of economic fluctuations shape individuals' risk attitudes? For the generation of "Depression Babies" it has often been suggested that their experience of a large macroeconomic shock, the Great Depression, had a long-lasting effect on their attitudes towards risk … we ask … whether people who live through different macroeconomic histories make different risky choices. Standard models also assume that individuals incorporate all available historical data when forming beliefs about risky outcomes. In contrast, the psychology literature argues that personal experiences, especially recent ones, exert a greater influence on personal decisions than statistical summary information in books or via education. …. Our estimates indicate that more recent return experiences have stronger effects, but experiences early in life still have significant influence, even several decades later. Our results can explain, for example, the relatively low stock-market participation of young households in the early 1980s, following the disappointing stock-market returns in the 1970s, and the relatively high participation of young investors in the late 1990s, following the boom years in the 1990s.*

We are at that horrible time of the year, when disaster often strikes; the talking heads remind us every two minutes. Not only has September witnessed the 9-11 strikes; it has historically been the worst month for equities. (One out of the twelve months has to be the worst, but that does not merit a mention). September 15th will mark the first anniversary of the Lehman bankruptcy, a fact we are not allowed to overlook. As the scholarly paper suggests, dramatic events can colour people's thinking. Lehman bankruptcy and its aftermath was the most dramatic financial event of recent decades; but we cannot let ourselves become the modern day equivalent of Depression Babies.

Trick Question
(Jun'09)

Even though three out of six months this year have been negative, the NIFTY Index is up 45% in 2009. In 2008, the NIFTY Index lost 52% - quickly tell us how many up months did it have? As every three year old in Mumbai knows, the answer is five! For all the double digit days, up and down, the NIFTY is very close to where it was one year ago. The market seeks to re-distribute capital amongst the players, and it does this by fooling most of the people most of the time. Violent moves in opposing directions – shaking out the longs, and then shaking out the shorts. In a curious twist of symmetry, the S&P 500 ended the month of June at 919 – the same level that as the May close.