Berkshire
DIVIDEND STRATEGY

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Practice Management Concepts

"Predictably Irrational"

Benjamin Graham: "The investor's chief problem – and even his worst enemy – is likely to be himself."

The Dalbar study shows investors left to their own devices are not good at investing. They keep making the same mistakes over and over (predictably irrational) and there seems to be no end in sight... https://www.dalbar.com/. Panic selling, chasing returns, and timing the market are all contributing factors to this terrible relative performance.

Why Do We Keep Making the Same Mistakes?

Let's nerd out a bit on behavioral finance -- Imagine this… someone blindfolds you. They take you somewhere completely unknown. You get to your destination, and they ask you to stand still. They remove your blindfold – you look down and you see this:

*Photo Credit: SkyDeck Chicago at Willis Tower

You're looking out from the observation deck of the Willis Tower 1,353 ft about the city streets of Chicago!

What's Your Initial Response?

If you’re like 99.9% of people you'll likely experience a rush of adrenaline and quickly jump back in fear for your safety -- "Why the heck am I way up here!"

There's science behind it, of course. Your brain's Amygdala regulates emotional and behavioral responses, especially fear [Amygdala Hijack: When Emotion Takes Over](). It serves many useful purposes but can also send false positives. The example above details how your brain can trigger this false positive. If the blindfold was kept on, you were standing on firm ground, there would have been no perceived risk and you would have never experienced this response. You were never really at risk and the same can often be true with investing...

False Positives

The same biological responses occur for investors -- Negative headlines perceived as a threat to their wealth and well-being. "Corona Virus Spreading" - "If _______ gets Elected the Market will Go Down -20%" - "Recession" - The body's "flight mechanism" is wired to spur you to take action now! "I'm going to lose money, sell before it goes down"! The Dalbar study seemingly proves the average investor simply **cannot overcome** that innate response. Biology trumps logic - at least initially.

Certain clients may be the perpetual culprits. One advisor just discussed how the same client asked to "raise cash now, the market is way overvalued" and then turned around the following week and instructed the advisor to "buy Tesla stock" - after the huge run-up. But successful investors don't tend to think of investing in terms of absolutes or "I might lose some money over the next few months so I better not invest."

Instead, successful investors take a long-term view based on logic - not emotion. They understand over the long run, they are investing in viable, sustainable companies with the ability to compound cash flow over time.

Keeping Clients on Track?

With the endless stream of CNBC headlines, client Amygdala’s are firing on all cylinders. So how do we keep them on track and help them avoid value-destroying behavior?

1. **Awareness:** show clients behavior studies like the Dalbar. They prove knee-jerk, emotional responses usually destroy value. Historically equities return about 10% per year (Source: Bloomberg). The market can favor investors long term; however, human brains are wired to lose.
2. **Emotional management:** *“The stock market is a device for transferring money from the impatient to the patient.” – Warren Buffett*
   This infographic shows the six common psychological pitfalls investors face: https://www.visualcapitalist.com/6-biggest-mistakes-ordinary-investors-make/
3. **Objectives-Based Portfolios: "Leave the Income Stream On" -** A common theme for most clients? They're seeking a growing stream of investment income now or at some point in the future. A dividend growth portfolio may align perfectly with these goals. If clients constantly tried to be in and out of the market, they would likely miss out on some attractive compounding,

and end up another casualty of the Dalbar study! On the contrary, if they stayed focused on long term dividend investing, they may achieve the income growth aligned with their goals. As a bonus perhaps owning recognizable companies, collecting dividends and receiving periodic "pay raises" could help clients stay calm and on track.

Follow some of these common-sense guidelines and help clients keep their "CNBC Blindfolds" on.

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