NEXT GENERATION INVEST

10x10

December 2022

Investing like a Nobel Prize winner: or, important to do one thing and imperative to do another...

Creating and managing a perfect investment portfolio is like winning the lottery - in other words, almost impossible. An investor already wins a great deal if, firstly, he does not shy away from pain and, secondly, does not remain stubborn. We can answer the question "Can you do it" with "Yes".

Readers of this column know that we at AGFIF International have been incorporating the theories of behavioral finance into our investment approaches and strategies for ages. So what wonder if we have embraced the insights of Daniel Kahneman, the famous behavioral economist and Nobel Prize winner. Kahnemann, who is also a psychologist, turned the doctrine of rational and efficient markets on its head with his Prospect Theory.

"When deciding to sell, people have control over whether they give themselves pleasure or pain, and they tend to give themselves pleasure. In other words, they tend to sell the winners and keep the losers. That turns out to be a bad idea." This famous Kahneman quote is Prospect Theory applied.

It states that rational reason does not work in the many bad decisions that investors make time and again. Risk behavior in the markets differs depending on the expected event, which leads to Kahneman's "bad ideas": Well-performing stocks are sold too early and loss-making stocks are held too long.

The reason for this can be found in Kahneman's quote. Gains give us the lesser amount of pleasure than the amount of pain that losses give us.

Recognizing and correcting this behavior, also known as the disposition effect, is one thing - it does not yet result in a tangible investment strategy. The other is to recognize the right time to make investment decisions, i.e. to buy or sell individual stocks or sectors. Even the most experienced investors know that there is no such thing as perfect market timing.

Sometimes you hit the right time to enter because a stock's valuation is very low when the economic outlook is changing for the better. Other times, you miss selling at the peak price because you want to continue to take advantage of the momentum.

In such constellations, investors are always faced with the same important question: Should I orient myself to the momentum, i.e. the "run" of a stock, so to speak? Or should I stick stubbornly to the fundamental data, such as the price-earnings ratio of a stock?

At AGFIF International, we are so humble in the face of the markets that we leave these decisions - buying and selling at the right time - entirely to the irrationality of the markets in the manner of Kahnemann. In other words, we have developed an algorithm that recognizes the behavioral patterns underlying the disposition effect on the basis of a trend analysis and gives buy and sell signals on stocks and sectors accordingly at an early stage. The prospect theory helps us to decide whether we should give higher weighting to fundamentals or to market momentum.

Through the corresponding, actively managed certificate, investors thus gain access to an equity portfolio that firstly achieves broad risk diversification with equity giants such as Apple or Amazon and with Swiss midcap pearls such as Komax or Comet. And secondly, they can benefit from a unique investment strategy based on a set of rules whose basic idea was provided by a Nobel Prize winner.

**Mojmir Hlinka is a director of AGFIF International in Zurich, the only Swiss asset manager that consistently bases its investment strategy on behavioral finance theory. Hlinka is a federally certified finance and investment expert AZEK and a member of the Swiss Financial Analysts Association.*