FROM BEHAVIORAL FINANCE TO ECCLESIASTES FINANCE:
THE PAIN OF GAIN AND THE GLORY OF AN INVESTMENT LOSS

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Abstract
Academic and practitioner’s literature has a plethora of evidence that active investment management is futile economically and underperforming financially, - more preponderant for large, blue chips. For smaller capitalization companies, purchased at discount there is an attractive, sustainable return promise, a long-term outperformance. We introduce a terminology that encapsulates this capitulation against this apparently overwhelming forces of tangible underperformance of active investment, inefficient asset allocation and high risk - low return portfolios, the era of Ecclesiastes Finance. Investors loathe to make decisions for fear of loss and discount all negative subtle announcement of the fragility of our gains and futility of our investment arrogance. And ignoring them can lead investors to make less fortunate financial decisions that can affect portfolio for decades. Investing with an Ecclesiastes attitude - the fragility of human condition in context of financial affairs - temporary gains and losses are less significant when framed in a larger perspective.

Key words
Advances on behavioral finance. Psychology, of financial loss, biases, market efficiency, gain and loss on investments

Classification
REL 5F, 5G, 5K, 7J, 7K, 7L, 10B, 10F
JEL: G11, G12, G14

1. Introduction and research question context

The continuous flow of cheap money helicoptered by central banker have led to more income inequality and have unfairly increased asset inequality along the whole spectrum of yield and maturity risk. Central banks assets have become the new liabilities: capitalism's business models - those dependent on a yield curve spread or on an interest rate risk that permit a legitimate return on investment saving, as opposed to the incentive for spending. The ineffectiveness of capital allocation to risk, the new era of Ecclesiastes Finance will be manifested by a limit on risk asset prices (both financial and real assets) and subsequently when the negative returns on these assets will persist, the investors will finally abandon any hope for future compensation as they were receiving historically. Active investment management is futile and underperforming, and this is more preponderant for large, blue chips. Only for smaller capitalization companies, purchased at discount there is an attractive, sustainable return promise, of a long term outperformance. We name this capitulation against this apparently overwhelmed forces of tangible underperformance of active investment, inefficient asset allocation and high risk low return portfolios Ecclesiastes Finance.

The research result concludes that for the period 1995-2005, the finance industry enjoyed sufficient investment return from classy and elegant efficient allocation of portfolios: More Risk or More Capital was the financial markets and central banking mantra for the period. Paper arguments that we entered into a new phase, 2005-2020, with insufficient return, and asset allocation to increasingly non-efficient portfolios: to meet the same financial goals, investors need to assume more risk and to invest more capital. Stable, negative correlation between fixed income and equity instruments was the rule in the post-crisis microenvironment. The regime shift in the financial markets out of central banks euphoric quantitative easing has made this diversification rule of uncorrelated bonds and stocks, less efficient. With yields expected to rise, long term bonds are less efficient as diversification instruments, shorter duration bonds look more efficient. Asset correlations increase during periods of financial stress. Almost all risk assets moved in tandem, since investors fixation only to macro events, transcending all asset classes and domiciles. Investors with different risk personalities, time horizons and strategies focus suddenly and simultaneously on clear and present dangers. Diversification, in times of bear markets stress, does not protect against systemic market risk or loss of principal risk. The real benefits of diversification manifest imperceptibly over a multi investment period.

According to the paper research calculation, the efficiency of an investment portfolios is mostly dependent on...
systematic factors (interest rate, exchange rates, other macroeconomic independent variables). With most readily available ratios, Sharpe for the period 1995-2005 > 5 times the Sharpe ratio for the period 2005-2015/20.

2. What is Ecclesiastes Finance?

The gap between from theory to the practice of Behavioral Finance (BiFi - a nickname) has direct application to the investment management practice. Students of Behavioral Finance can develop useful knowledge and skills employed in their practices for their clients. Behavioral Finance can teach about mental, emotional, psychological and social biases that lead to mistakes and biases from market efficiency, about exploitable pricing anomalies and other market dynamics and risk – return investment outcomes. The new science of BiFi, or PsiFi is transforming how we think about relationship between the investor and the investing. With the advent of technology, the Internet Investing is changing how individual investors are managing their money. The practical application of BiFi can help investors discover how individual and group herd behaviors can lead to biased, counterproductive investment decisions. So, we understand the resorts behind decision-making processes and develop practical tools to improve our portfolio and risk management technology for the scope of improved service for client and to of a larger contribution for the better good of society at large.

Our long-term investments carry a significant emotional weight. Investors dislike stocks and bonds but have an emotional, not investing approach to their real estate. People fall in love with their houses in a way that they never fall in love with their portfolio of stocks and bonds. Investors loathe to make decisions for fear of capital loss and would prefer to discount all negative subtle announcements about the fragility of our gains and futility of our investment arrogance. And ignoring signals can lead investors to make less fortunate financial decisions that can affect portfolio for decades.

From an investor's perspective, it looks like there is not very much fundamental investment logic in today's market high valuation and high volatility. Apparently, classic financial wisdom, elegant fundamental and technical analysis, comprehensive market and subtle behavioral analysis are of limited use in protecting investor’s capital, not to mention increase it. Apparently, all an investor can do is to survive, get through each trading day as best as possible with at least loss of capital as possible, trying to do the right thing, avoid consequential mistakes, hoping for the best scenario. Individuals are long term investors only as long as the markets are rising. Despite endless warnings, repeated suggestions and clear recommendations. As a major behavioral bias of investors, as long as the markets are rising, convincing investors to sell, manage portfolio risks and take profits is difficult to overcome. By the time the pandemic fear, market desperation, investors capitulation or panic stages are reached, it is far too late to act and all previous gains could be wiped out easily. A 50% capital loss has to be compensated with a 100% gain. Notwithstanding the opportunity cost/lost profit that has to be gained as your more prudent competitor avoided the initial loss of your magnitude. And while competition made 50%, you were losing 50%, so to break even with her, you need at least 200%. And this is impossible, except for a martingale bet. Will the investor be tempted to assume such an undue risk? A rational investor, most probably no.

The two-behavioral finance research that received Nobel prizes has lured the academia research in the interdisciplinary path where fundamentalists, statisticians, psychologists, physicists must work hand in hand to find new universal laws to explain the financial markets machinations. It was not just media, but even psychologists who were bent on burying classical economics. Efficient market hypothesis was presumed dead. It was considered deficient, but over the years, defending the underdog changed to understanding the new theories and then finally even questioning them (Shiller’s irrational exuberance, end of behavioral finance, etc.). It’s a rivalry between perception and reality at a certain point of time, which of course is dynamic, and leads to new perceptions and new realities at any new points in time. Bears in bull market and bulls in bear market assume contrarian decisions (against the general trend or momentum of the market). When the respective trade options lead to negative results (e.g. negative return vs. market index), the investors are much more penalized (financially and emotionally) that are rewarded those who took contrarian decisions that led to positive results. So, in cases of contrarian investment decisions, the emotional and psychological implications of a negative result bring in significant emotional discomfort that upsets much more, in absolute terms, than pleases a positive result.

With the perspective of behavioral finance approach, investors will always prefer to follow the current trend rather than counter expose their investment portfolio. If market would have been highly efficient, accordingly, stock prices are extremely difficult to predict in the short run, and that new information is very quickly incorporated into prices. These theoretical findings not only had a profound impact on subsequent research but also have changed market practice - the emergence of ETFs, low cost index funds in stock markets all over the world is a prominent example. Behavioral biases are detrimental to the investment return of individual investor portfolios. As a direct influence of behavioral biases, the intuitive correlation between risk and return does not hold. Low risk investments have the highest returns along all dimensions of the market.

High risk investments do not return efficiently the investors capital. The practical findings contrast the principles of efficient markets – high risk is not correlated with high expected return and low risk/safe investments have
highest investment returns. Research in behavioral finance has important practical and academic applications in providing such explanations and tools for risk administration rather than return maximization.

The behavioral finance research can help guide investment portfolio allocation decisions, both by helping the understanding the kind of errors that investors tend to make in managing their portfolios, and also by allowing us to understand better how to allocate assets and locate profit opportunities for investment managers. Systematically beating the market by outsmart moves, ahead of competition, finding undervalued and overvalued securities and implementing the buying and selling decision at the right timing and with sufficient capital is difficult, if not impossible, in the long run, sustainable way. Active investment is strongly influenced by behavioral biases. Based on local market data (e.g. Romanian Stock Market), the paper contends that benefits of active allocation are small and unsustainable. Careful asset allocation and appropriate timing of rebalancing can improve the chances of higher portfolio efficiency. Investors should be better off by focusing on asset and sector allocation and less on security selection and market timing. Investors put too much weight into most recent financial experiences and ignore a longer term, larger perspective. They evaluate other player’s decisions as discretionary and non-rational and assume their own decision to be logical and rational, and in conformity with all existing information.

3. Both pain of loss and the glory of gain are temporary

According to Morningstar Inc. and other market data, the ratio of the S&P 500 index that is now owned by passive investment funds and ETFs doubled since 2005, from 4.6% to 11.6% today. Only one manager – Vanguard controls 5% of shares in 468 companies in the S&P 500, from only 3 companies in 2005. Today’s average investor is more inclined to let others, (ro)bots including, manage her money. Superior performance takes time to convince the investing public, but once victory is won through a stream of sustainable higher returns, active investment industry has reached a point of no return. Passive investing is easy, simple to understand, cost effective and does not need exceptional expertise. According to Morningstar, 2/3 of mutual funds and ETFs (exchange traded funds) are still actively managed, the figure is down from 5/6, as it was 10 years ago. For today’s consumer of investment finance products, low costs and effort to understand are essential.

As of 2016, The Vanguard Total World Stock Market Index Fund has 7,600 securities. The Vanguard Total U.S. Bond Market Index Fund and Total International Bond Market Index Fund collectively have 12,400 securities. Investment universe has around 15,600 mutual funds, 11,000 hedge funds and 2,100 ETFs, with 50% more of these funds available than there are individual stocks and bonds. Investors almost indifferent to buying opportunities at incipient phase of a bull; they start to be interested when upside trend is obvious; buying spree makes a clear upward. Is it the same on the downward?

Nobody wants to be just a spectator of the game; everybody wants a piece of action - a non-rational herd instinct. To compound the problem, the objects of investor affection is represented by those stocks that performed dearly lately and are obvious most exposed to the eventual correction. The most powerful emotional drive in any asset sale is loss aversion - not wanting to sell for less than acquisition price. But painfully, the current market price has nothing to do with how much the investor actually paid for it.

Investors overestimate their individual abilities in terms of luck, education, intellect and aptitude to process, disseminate and understand the market. It isn’t entirely clear why investors and homeowners are usually so cheerful about the future, the researchers postulate it may result from the “money illusion” - a failure to take inflation and the opportunity cost of capital into account and to be overly optimistic about the future. Although there is a low correlation between professional abilities and investment success, investors have high confidence that somehow, someday they will succeed in beating the markets. Price is supported and resisted by a multitude of educated, determined, intelligent, psychologically tough individuals that act for single scope, to maintain fun and privilege, to survive as market player.

Preserving interest rates too low for too long inhibits capitalism with very low/negative yields that corrode and extinguish the functioning of business models. This high maintenance monetary machine changes the pecking order logic of savings, investment and return of and on capital that ultimately influences the economic growth and the standard of living; net interest margins for banks, solvency ratio of insurance companies and funded ratio for pension funds with long-dated and underfunded liabilities, all these institutions pay the price of a generalized over-expansionary monetary policies that have led to gradual capital destruction as opposed to capital creation and efficient risk pricing and allocation.

Significantly for individual investors, the pandemic monetary quantitative easing also lowers borrower’s ability to pay for future debts and to enjoy real purchasing power of their retirement benefits. Financial risk taking, as opposed to real economy risk taking is not returning sufficient return, if anything. Investors value the evasion of discomfort of losing capital. Losing 10% of wealth hurts almost three times as much as adding 10%. The preference for loss avoidance, in a Darwinian perspective, is a success factor. To compound the problem, the objects of investor affection is represented by those stocks that performed dearly lately and are obvious most exposed to the eventual correction. In the new era of Ecclesiastes Finance the investors can abandon any hope for future compensation as they were receiving
historically. Active investment management is chronically underperforming, and this is more preponderant for large, blue chips. This capitulation against this apparently overwhelmed forces of tangible underperformance of active investment, inefficient asset allocation and high risk low return portfolios Ecclesiastes Finance.

4. Zen Finance: individual investment management with the scope of peace of mind

With an omnipresent uncertainty, investors should try to protect financial wealth rather than seek an incremental, marginal, non-risk efficient, nominal-only investment return. A more stress-limitation (Zen Finance approach to management of individual’s investment portfolios) investment strategy is advisable. By fear of losing opportunity, investors do not keep temper, act impulsively, extrapolate short-term trend into a long-term investment attraction. Risk profile changes, investors appear to be able to bear more risk that would be otherwise reasonable, advisable and rational. This is not sustainable on long-term, and is surely a losing proposition for the investors. A Zen Finance approach on individual investment management is more advisable.

Humans, investors have a basic tendency to risk aversion rather than to risk seeking. Success strategy of our ancestors went through their daily surviving challenges being more risk averse than risk taker. This evolutionary pressure is asymmetric to risk avoidance for a simple reason that is more efficient to lose an opportunity (to extra feed yourself) than to put yourself in the harm’s way and risk a dramatic reduction …in life expectancy.

Similarly, in today’s complicated maze of financial preoccupations and challenges, central banks are keep on doing whatever it takes to monetary support the economy, the over leveraged corporations and the over indebted population. The main counterargument of current monetary ultra-expansionary policies is it’s the pervasive effect on interest rates, cost of capital and the required rate of return for investor. For exemplification, over the last decade, between 71% and 93% of active U.S. stock mutual funds underperformed the benchmark index funds they are trying to beat, so that this massive money migration from active to passive looks like a generalized trend. Passive index funds’ expense ratio is very small by comparison with active, more than 30 times. With investment return and nominal interest rates or near zero, even the smallest fees stand out as a drag to performance, more than ever. For a pension fund, with long investment horizons but also with elongated liabilities coming from pensioners living longer and in better shape, this very small difference compounds to a significant difference in the value future benefit.

This counterintuitive challenge is against a basic credo embedded in our human instinct - our ability to control and be in control of our destiny. Passive investing, at a mental-intellectual level, looks like a capitulation, an explicit recognition of stock picking ignorance. It looks like abandoning the privilege of own decision, but still the best choice in management of own investing assets. The so-called investing passivists are less and less interested in active stock picking for the illusory extra return. The most representative archetype of active investing, hedge funds, have underperformed bourse general indexes since 2008. If markets are considered efficient, then active investment management is of no great use to the investor. Investment activity does not provide sufficient, if any, after costs extra return. Mantra for the industry performance looks like over promised and under delivered. Active investing is a about a nice presentation story, an attractive narrative but with insufficient return. Passive is about data and sustainability and no-worry (in a new article, we call it Zen Finance) that a stellar performance is followed by a very poor return. Passive investing gives up the chance to overperforms the overall market, but more importantly, avoids the adverse change in fortune to underperformance.

And if professors are fighting over academic leadership over the subject of financial loss, one can easily can understand why the “loss” Google search handles is mostly that of “weight”. The psychology of a weight loss is positive and motivational unlike the psychology of a monetary loss, which can be pretty discouraging. But despite all pessimism around the subject, understanding loss aversion as an investment strategy and even a successful one.

Loss aversion can explain why a price “bid/buy” on or off a trading screen is always lower than “ask/sell” prices. It’s not just because sellers always ask for a higher price than what the buyers can pay but because people attach more discomfort with a loss of “X” then the preference they experience to a gain of “X. In other words, people attach more value on giving up an item than on receiving it. Giving up is tougher, more emotional valuable and hence a perceived loss. So, it is not the reality of loss that matters but the perception. And propensity to be loss averse is somewhere connected to a real loss. The more investor tries to avoid it, the more it grips her. That explains why liquidity is usually much higher at market tops than a market bottom correction. More investors are buying at top of the bull market than they are buying a lowest point. And loss aversion combined with inability to admit or learn from mistakes can only complicate investment decisions, delaying them till they are of no use, as in a capitulation.

Dissatisfaction of a negative result, after a contrarian decision, weights significantly higher than eventual satisfaction from a contrarian decision, so investors find it difficult to assume au contraire decisions. If investor deviates from a conservative diversified portfolio she becomes vulnerable to the pain of regret if things go badly because it is easy to imagine having done the appropriate action (e.g. fully diversify or reduce equity exposure). When it comes to the long term, we mostly regret inaction. In the short term, we regret action.

`The spectacle of modern investment markets has sometimes moved me towards the conclusion that to make the purchase of an investment permanent and indissoluble, like marriage, except by reason of death or other grave cause,
5. All money success is vanity: The temporary pain of gain and the permanent glory of loss

Behavioral finance does not eliminate but complements the standard evaluations approaches - fundamental, technical and markets analysis. Comprehensively, it combines the findings of all valuation procedures with the investigation of social, psychological emotional aspects of the market, and relaxes the old strict requirement of convergence between price and value. Since markets are always about high financial, political and social stakes, is not wonder that most of the time the subjective emotions dominate the objective and logical approach. Behavioral analysis considers the elements of human perception and evaluation of an outside situation and event, and most importantly, the emotions associated, ex-ante and ex-post with any financial decision. This behavioral field of modern finance refers to neuroscience debate and assertion that the motivations, emotions, and feelings are indispensable to any human decision, including the financial ones; emotions are essential to any decision and course of action.

The investors interpret market data and events at two cognitive levels: the intellectual level of ordination, process and analysis of real factors (economic data), and the logical and rational level of understanding what this objective identifiable factors will influence the perception of the other players on the market (psychological factors).

High mathematics downplays intuition as unsystematic, emotional, and unaccountable. However, the more analytical investor moves into time systems and tries to mechanize entries and exits, the more he realizes that he can never eliminate risks. Actually, he discovers that he likes a certain amount of risk. At the heart of things, we are all investors, with knowledge and instinct, a part of the same Darwinian chain of economic survival of the fittest. Execution of a trade in the market is about intuition. Stock market insight is a high skill for life. Investors confuse intuition with speculation and herding. The intuition system is not fast moving, but insinuates in time, with experience, failures. Intuition systems are not about trends. They guide investors with understanding the minimal risks. What is a minimal risk entry or exit? Intuition systems are also built on patience. An investor can’t have an intuition system based on stress related to certain expiration of a financial opportunity.

An intuition system is something which gives investor the confidence to buy derivate puts, loose capital, but rollover out-of-the-money option at expirations. If investors are bleeding capital every 18 months, it is a minimal risk, not a high risk, but if investors buy puts and calls every month, they have no intuition system. The problem with intuition systems is that they are generally about a market crash or scary bubbles in valuations. A real intuition system works both ways. A test of intuition systems can differentiate between underperformance and outperformance. But then intuition systems can’t do everything. A performance ranking could be a good decision support for our intuition systems. The best of the best is to be avoided, and the worst of the worst are to be selected. This simple idea can give investors the behavioral courage to listen to her financial intuition.

How, from a behavioral perspective should an investor make sense of this complicated picture? Pain is detestable, gain is attractive. But pain and gain could be temporary and today’s winning position can become a drag, and vice-versa. This is why we stick to our losing investments (postponing the realization of our poor decision crystallized into a loss) and tend to sell too early our investment winners just to be sure we truly can hoard that hard-earned cash. The gain comes with the pain of eventual loss: we just sold our winning investment just to see how it continued to grow; and by the time we are flabbergasted by our behavioral bias and buy again into that stock, we immediately start to slope down, just to complement the upside-omitted gain with the downsized-committed loss. Investors value the avoidance of pain of lost capital. We value less the pleasure of gain. Losing 10% of wealth hurts almost three times as much as adding 10%. The preference for loss avoidance, in a Darwinian perspective, is the success factor. And how can investors measure success other than by surviving and eventually by multiplication of their genetic wealth as a strong administrator of survival risk. Humans are loss averse. And the individual, corporate and society, which understand it, thrive despite odds. "How did this stuff ever get published?" was what traditional economists asked when behavioral economists observed that human beings were loss averse. This fundamental aversion to risk is at the heart of human psychology and asset pricing models of modern finance.

6. Why is this topic interesting to research?

Standard finance demonstrates asset prices models that are built on the credo that individuals are risk averse and on hope for positive correlation between investment risk and expected return. Statistical evidence supporting this relationship is weak to non-existent, only marginally significant. Some of the most preeminent investors keep on asking three adages:

Does active money management add investment value systematically?
- “The speculative public is incorrigible. In financial terms, it cannot count beyond 3.” - B. Graham
Why we are most certain that we are right just when we are being most likely to be wrong?

- “The riskiest moment is when you're right. That's when you're in the most trouble, because you tend to overstay the good decisions. So, in many ways, it's better not to be so right” (W. Buffett).
- A good investing advice is not theoretically ideal by psychologically practical. Investors feel they need something to do with their capital; i.e., impulse urge for the illusion of control.

Is investment portfolio diversification meaningless?

- That's what diversification is for. It's an explicit recognition of ignorance” (Peter Bernstein).
- “Neuroscience of investing helps explain one puzzle after another: why we chronically buy high and sell low, why “predictable” growth stocks sell at such high prices, why it’s so hard to understand our own tolerance for risk until we lose money, why we keep buying IPOs and “hot shares” despite all the evidence that we shouldn’t, why stocks that miss earnings forecasts by a penny can lose billions in seconds” (Steven Zweig).

7. Active investment: on a risk-adjusted return, overpromise and underdeliver

The classic evidence of investment overpromise and underdeliver is the US market index S&P 500 decreased between October 2007 peak to March 2008 bottom, about 57%. An investor needed to gain 133% return immediately after that, just to compensate for the previous huge loss. Home prices index decreased between 2006 to 2008 by 34%; similarly, the compensatory gain should have been more than 52% just to make up, to break even. At a 50% decrease of investors wealth, the 100% necessary increase break-even point, assuming a 6% (an approximate the long-term return on equity invested capital) annual increase rate, it would take a lucky stream of a full 12 years of uninterrupted gains (rule of 72). It is than of no surprise that lately investors got very happy with the flood of monetary stimulus, with renewed confidence that, whatever happens, the central banks will be either lenders of last resort or buyers of last resort that will prop-up prices, no matter what, doing whatever it takes. Evidently, the prime beneficiary of this intervention is the market, there is a strong interdependence between personal experiences (autobiographical memory) and interpersonal dynamics of market players (their emotions and sentiments). Due to uncertainty and continuous change in the game of the market, there is a strong interdependence between personal experiences (autobiographical memory) and interpersonal dynamics of market players (their emotions and sentiments). The information has investment value when is correlated with professional knowledge (human intellect) and interpersonal dynamics of market players (their emotions and sentiments). Due to uncertainty and continuous change in the game of the market, there is a strong interdependence between personal experiences (autobiographical memory) and interpersonal dynamics of market players (their emotions and sentiments).
and implement an investment tactic that is feasible, easy to understand, amend and manage within the risk boundaries that are generally accepted. Understanding the psychological foundation of human behavior in financial markets facilitates the formulation of investment policy statements for individual investors.

The general public is searching for people of trust. More broadly, they viewed behavioral and ethically related attributes, such as fairness, transparent business practices, responsiveness in addressing broader issues, integrity and socially responsibility are at least as important as performance-centric metrics. An investment adviser’s utility therefore is overwhelmingly bound up in his or her ability to uphold highest ethical principles in stewarding the customer’s assets for future growth. Demands from customers on Main Street are ushering in a new era: the era of the fiduciary. As investment management, finance advisor or academic, we all have a full social and professional responsibility for a new fresh public mission on elevating the subject of trust and fiduciary duty to the customer of financial services and investment management advice, our students, investment public in general, and in the end, to the society. Leaders in the industry urgently need to adhere to a culture that is built on a system of trust. Clients and their investment professionals must work as partners with aligned objectives, which means that a fiduciary culture is embodied by long-term compensation schemes dependent on client success and maximum concern for caretaking of public trust and confidence.

The long-term success of a relationship depended more on not doing bad things rather than on doing good things. Bad reputations were easy to acquire but difficult to lose, whereas good reputations were difficult to acquire but easy to lose. The overall goodness of a person was determined mostly by his worst bad deed, with good deeds having lesser influence. Even pessimism not optimism uniquely predicted psychological and physical health outcomes. The universality of stronger bad over weaker good was unequivocal. But honesty remains the best policy.

Life is full of bad and good instances and how bad was predictive, underestimated, more lasting, more pervasive, elicited more processing, got more attention, was more unusual, was connected to speedy decision making, universal and simply stronger than the good. The TV news is more bad news, starting from refugees, migrants, middle east, to money managers’ insider trading, to natural catastrophes. Bad happenings interest society more than the good. The few good things seemed to be the good life ads interspersed between the bad news. Life was like full of bad memories, which we systematically erase to stay positive. People dramas, reality TV shows and other people trouble are our way of having fun.

The strength of bad was also visible in the stock markets. Investors attached more weight to a loss than to a gain. This is a primary the reason for our risk aversion. This was also the motive why there were more momentum investors tracking winners, compared to contrarian bets looking at depressed losers. Trauma has no true opposite concept. Unlike many good experiences, a single traumatic experience can have long-term effects on the person's health, well-being, attitudes, self-esteem, anxiety, and behavior. Ability to feel pain has served humans well on both a personal and an evolutionary level. People, who fail to feel pain, fail to adapt and die early. People who write about their most traumatic experiences typically show significant improvements in physical health, as compared with the control group. Market panics also have an ability to inflict a generational pain, which create new financial habits, probably more informed and more conservative. The Swiss Franc will have to wait to become a credit currency for real estate investments in Romania. How we all handle bad events, financial loss, failure of pain, subconsciously or consciously, is our choice. If we are conscious about it, we might learn more from losses than gains. As humans, we might embrace the bad “worst” losers more than the fast shining "good" winners. We side with the underdog. In the end, we have a survival kit psychological framework that keeps us alive. It is, however, our only conscious decision making that can create wealth and keep us in good mental shape, while we enjoy it or prepare to transition to next generation. An intergenerational time horizon for our investments can reduce the stress of absolute return requirement.

8. Having time is the new money. Having Fun is the new commodity. Health is the new asset.

It may appear funny to use the news headline indicator to predict stock prices, but as an indicator, it makes money. When we first read about the headline indicator, it seemed like a funny joke. The social mood was linked with stock market expression. Human emotions are rhythmical and have wave nature. And these waves are hypothesized to govern all human activities including business, politics and pleasure, what is in vogue. When mood trends up, people buy houses, stocks, just like they buy clothes, film tickets, jewelry and clothes. And when the social mood trends down, the broad consumption pattern flags and people don’t buy stocks, they sell and started looking for rents. And how humans oscillate between positive and negative moods i.e. between concord and discord, inclusion and exclusion, forbearance and anger, confidence and fear, embrace and avoidance of effort and risk, practical and magical thinking, constructiveness and destructiveness, desiring and imposing power, all of which has a consequent effect on markets trending up or down. Knowing yourself is paramount key to better informed, sounder, investment decisions.

People desire change and like challenges, or at least bring it about, even when it appears superficially or just for fun. For example, adversity eventually breeds a desire to take charge and responsibility, achieve and succeed, while prosperity eventually breeds less responsibility, more complacency and finally sloth. Events are perceived as turning points for mankind. This is conventional, cause and effect relationship. The very reason it does not work. Turning points are generally the opposite as each positive point is a step towards negativity. And each negative point is a step
towards positivity. Homo oeconomicus produce more goods and services when the dominant social mood is positive; he borrows too much and save too little. They enjoy good life and good living now, and less preoccupied by the consequences of not paying enough attention to investment risks.

The reason for the lag between the mood (in behavioral finance, mood is assumed proxied by stock market) and the result is that people take time to put their new-found energy to work and risk acquisition. And then reap the fruits of its employment. If we plot graphs on depressions, recession and economic booms, the correlation is evident. For example, the social mood and economic prosperity also connects people preferences for cars and luxury items. As we go up in stock markets our color preferences are changing. And as our preferences change to transition colors like grey and silver moving to brown and green cars, we as a society are becoming more negative, expressing our mood in our preferences and attitudes toward our finances.

We can afford to be sharp when we go up, but as we go down, smoothing the edges becomes imperative, be it cars or clothes or shoes, rounding just gets in. It has also to do with our ability to visualize. We cannot see inversions like inverted yield curves or an inverted picture. There are a host of trend studies about when we like ghost movies and when we appreciate animation. Why making more babies is a positive social mood? And being single or an ageing society comes after a society undergoes negativity in social mood?

As the future is going to be more socially complex and these are times we as a society don’t enjoy celebration of love and fraternity but stars dramas, big screen sex and sirens. Markets lead events and events are caused by the social mood. Investors are indifferent to opportunities at incipient phase of a bull; they start to be interested when upside trend is obvious; from then on, the buying spree makes a clear trend. Nobody wants to be just a spectator of the game; everybody wants a piece of action - a non-rational herd instinct. Rational however, it should be clear that the upward trend need not to continue indefinitely. Social mood, is, however, highly volatile, it can change most easily on the negative, depressing and pessimistic.

9. Demand supply behavioral dynamics

Demand-supply dynamics are not only differentiating economics from finance but reshaping capital market research. At a party one may find that five out of ten may have the same birthday, which is quite a coincidence as the gathering was small. Why? There is no traditional answer for his question. Just like clustering of market prices were a cyclical reality, and such coincidences happen again and again with cyclical precision.

The age of confluence is full of many such coincidences and witnesses a mixture of cultures, thoughts, sciences, information and above all the human emotion, which continues to oscillate from one extreme to the other, changing the way we comprehend and see things. This is why time and again traditional or conventional research has come under fire. How accurate is it? How accountable and how relevant?

![Value Function in Prospect Theory](image)

Prospect Theory (Kahneman, Tversky [1979, page 263-291]), value function is concave in gain domain and convex in loss domain.

- Loss counts much more than same value of gain.
- Prospect theory offered the first significant alternative to the expected utility paradigm that dominated research in modern finance.
- Based on experimental evidence about human behavior under uncertainty, built to fit the evidence rather than embody an abstract sense of rationality.
- Prospect theory relies on evidence that when making economic decisions people are easily influenced by framing, that is by the context and ambience that accompany the decision problem.
- Part of this context is generated by the people themselves, as when they adopt arbitrary mental accounting of their financial circumstances.

![Figure 1. The Prospect Theory: concave gains and convex loss](image)

Not only the environment but our most recent financial results have a significant impact on how we prospect and frame an investment bet. When we feel emotionally powerful and economically wining we are greedier and less
socially polite, just as we are behaving less ethically when part of deindividuation, anonymous group (e.g. Internet haters). We like more a person after we have done her a favor and less after we requested her a favor.

Today’s volatile markets systematically complicated the decision-making process, especially on the money management dilemmas. The stress hormones, adrenaline and cortisone, although highly efficient defense mechanism from an evolutionary perspective, can severely impair our ability to make clear-head decisions in the daily fragility and volatility of the stock market. When we are, nervous and stressed, our ability to think clear diminishes and we become more pessimistic, lose our ability to think clearly and concisely, and become more impatient.

Increased level of stress, in line with financial and personal high stakes involved in our investment decisions, lead to biased information-processing mistakes, like overtrading, overconfidence or illusion of control. Our behavior biases and tendencies can harm the investment performance of our portfolio. We feel contented by the illusion of action. Subjected to stress, our brain would rather favor action than inaction, thinking and planning. Rational analysis mixes with up with our gut reaction and prejudices and we often forget that there are no shortcuts to the places really worth going. Misses Market has no indulgence on our urge to make quick money.

In the article „Emotional Intelligence and Investor Behavior” of John Ameriks, Tanja Wranik and Peter Salovey conducted a survey on private held portfolios. Investment performance correlates positively with high Emotional Intelligence (recognition and usage of one’s emotions in a productive manner) scores. However, the main presupposition of intelligent investing is that a constant supply of counterparties trade in the market, probably less emotionally and financially intelligent. Common sense would relate investor emotional intelligence with a better ability for decision making, and consequently a more systematic and disciplined approach on managing financial affairs. A person with high emotional intelligence, is by definition, an individual that is able to identify, comprehend, and regulates her emotions in decision making and problem solving.

Financial Personality and emotional features of an individual have both destructive and destructive effects in the financial decision making process. Investment decisions are often constrained by time pressure, social rules and regulations, and the continuous change and uncertainty of the market place. As such, monetary and financial decisions are significantly influenced by psychological factors. The topics presented make reference to ideas and research of the great savants of modern finance. They range from Kahneman and Tversky (asymmetric predisposition of individual’s response to losses and gains), Shefrin, Statman, Barber, Odean (selling winning investments too early and keeping the losing one’s too much), Statman (theory of regret; regret by omission vs. regret by commission), Gilovich, Griffin, Kahneman (cognitive heuristics and biases).

10. The Pandemic Yield Famine: Insufficient return - i.e. more risk or and more capital


**Table 1: Investment efficiency; diversification worked just fine: 1995-2005:**

<table>
<thead>
<tr>
<th>Probability</th>
<th>Equity fund % (s)</th>
<th>Bond fund % (b)</th>
<th>50% equity + 50% bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recession</td>
<td>1/3</td>
<td>-7</td>
<td>17</td>
</tr>
<tr>
<td>Normal</td>
<td>1/3</td>
<td>+12</td>
<td>+7</td>
</tr>
<tr>
<td>Boom</td>
<td>1/3</td>
<td>+28</td>
<td>-3</td>
</tr>
<tr>
<td>Expected return</td>
<td>11</td>
<td>7</td>
<td>9</td>
</tr>
<tr>
<td>Variance</td>
<td>204.7</td>
<td>66.7</td>
<td>9.5</td>
</tr>
<tr>
<td>Standard deviation</td>
<td>14.3</td>
<td>8.2</td>
<td>3.1</td>
</tr>
</tbody>
</table>

Sufficient Return and efficient portfolios: More Risk or More Capital:

A stimulus-induced investment return made up for lost principal, during 1995-2005:

- \( \text{Cov} (s, b) = 0.3333(-7-11) (17-7) + 0.3333(12-11) (7-7) + 0.3333(28-11) (-3-7) = -116.67 \)  \[1\]
- \( \rho (s, b) = \text{cov} (s, b) / \sigma_s \sigma_b = -116.66 / [((14.3) (8.2))] = - 0.99 \)  \[2\]

**Table 1 conclusions:**

- In a normal monetary policy word, expected return per unit of risk (standard deviation) of a 50%/50% simply diversified portfolio (9/3.1) is significantly higher than for the riskiest equity placement (11/14.3).
- Most simplistic diversification multiplies investment efficiency, in the presented scenarios by 3.77.

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Table 2: Risk return Scenarios indifference is robust efficient; diversification for dummies 1995-2005:

<table>
<thead>
<tr>
<th>Probability</th>
<th>Equity fund % (s)</th>
<th>Bond fund % (b)</th>
<th>50% equity + 50% bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recession</td>
<td>1/4</td>
<td>-10</td>
<td>5</td>
</tr>
<tr>
<td>Normal</td>
<td>1/2</td>
<td>+6</td>
<td>-2</td>
</tr>
<tr>
<td>Boom</td>
<td>1/4</td>
<td>+12</td>
<td>-5</td>
</tr>
<tr>
<td>Expected return</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Variance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Standard deviation</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Except for a major correction in the market, the diversification is indifferent to economic scenarios.
Efficient portfolios compromise: More Risk or More Capital 1995-2005:

\[
\text{Cov}(s, b) = 0.25(-10-3.5)(5+1) + 0.5(6-3.5)(-2+1) + 0.25(12-3.5)(-5+11) = -20 \quad [3]
\]
\[
\rho(s, b) = \frac{\text{Cov}(s, b)}{\sigma_s \sigma_b} = -20 / [(9)(3)] = -0.75 \quad [4]
\]

Table 2 conclusions:
- The ineffectiveness of capital allocation to risk, the new era of Ecclesiastes Finance will be manifested by a limit on risky asset prices (both financial and real assets).
- Subsequently when the negative returns on these assets will persist into recovery, the investors will finally abandon any hope for future compensation as they were receiving historically.

Table 3: Insufficient Return, non-efficient portfolios: both More Risk and More Capital
It takes a lot of extra interest/return to make up for the lost principal 2005-2015/20:

<table>
<thead>
<tr>
<th></th>
<th>1995</th>
<th>2005</th>
<th>2015</th>
<th>Expected 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds allocation</td>
<td>100% bonds</td>
<td>52% bonds</td>
<td>12% bonds</td>
<td>5% ST bonds</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>5% LT bonds</td>
</tr>
<tr>
<td>Large cap allocation</td>
<td>0% large equity</td>
<td>20% large equity</td>
<td>33% large equity</td>
<td>25% large cap equity</td>
</tr>
<tr>
<td>Higher risk Alternative investments</td>
<td>0% alternative investments</td>
<td>5% small 14% int’l 5% real estate 4% private equity</td>
<td>8% small equity 22% int’l equity 13% real estate 12% private equity</td>
<td>10% small equity 25% int’l equity 15% real estate 15% private equity</td>
</tr>
<tr>
<td>Expected return</td>
<td></td>
<td></td>
<td></td>
<td>7.5%</td>
</tr>
<tr>
<td>Standard deviation</td>
<td></td>
<td></td>
<td></td>
<td>6%</td>
</tr>
<tr>
<td>Sharpe ratio</td>
<td>1.25%</td>
<td>0.85%</td>
<td>0.45%</td>
<td>0.3%</td>
</tr>
</tbody>
</table>

Table 3 conclusions:
- The pandemic monetary quantitative easing also lowers borrower’s ability to pay for future debts and to enjoy real purchasing power of their retirement benefits.
- Financial risk taking, as opposed to real economy risk taking is not returning sufficient return.
- Ecclesiastes Finance - capitulation against an apparently overwhelming forces of tangible underperformance of active investment, inefficient asset allocation and high risk low return portfolios
According to calculation, the efficiency of an investment portfolio is highly dependent on systematic factors (interest rate, exchange rates, other macroeconomic independent variables). With most readily available ratios, Sharpe for the period 1995-2005 > 5 X Sharpe for the period 2005-2015/20.

One critical assumption is to consider the return distribution as normal or lognormal. In a normal distribution, return distribution intervals have a constant measure, in a lognormal distribution, the intervals value depends on the relative value of stock price. If stock price variations are independent, the return distribution is normal, and if log differences are independent and have a finite variance, the price distribution is lognormal. An efficient, fair market should preclude an investor to infer immediate evolution based on past evolution. Expected, most likely scenario is an extrapolation of past performance.

11. Conclusions

The paper shows that behavioral biases are detrimental to the investment return of individual investor portfolios. Research in behavioral finance has important practical and academic applications. The research can help guide investment portfolio allocation decisions, both by helping the understanding the kinds of errors that investors tend to make in managing their portfolios, and also by allowing us to understand better how to allocate assets and locate profit opportunities for investment managers. Understanding the psychological foundation of human behavior in financial markets facilitates the formulation of investment policy statements for individual investors.

The paper presents a critique of standard investment analysis, fundamental and technical, and develops an alternative more comprehensive approach that should include some of the tenets of behavioral finance. People destroy their financial wealth by acting on behavioral impulses, by outweighing probability of outcomes that are merely probable and by assuming investment decisions based on emotional impulses. The research paper presents strong opinions for investment discipline and coherent, long-term investment policy. Methods that originate in psychology are used as research tools, along with traditional finance research methods. Over these years, the academic and practitioners’ world of finance have seen the blossoming of behavioral finance into a significant body of knowledge. The combination of theoretical and empirical work has allowed us to see the relevance of the basic psychological theories to many financial phenomena. As a direct influence of behavioral biases, the intuitive correlation between risk and return does not hold.

Low risk investments have the highest returns along all dimensions of the market. The practical findings contrast the principles of efficient markets – high risk is not necessarily correlated with high expected return and low risk/safe investments have highest investment returns:

- Investment managers have succeeded in creating false impressions as to their superiority as investors.
- Evidence in the academic finance literature shows that actively managed stock market mutual funds have generally been worse investments than funds that follow a passive investment strategy; the monetary global flood has one undisputable outcome: separation of performance between active and passive investment.
- Professional investment managers do not seem to do particularly well in selecting their own portfolios either.
- The newly developed body of knowledge in understanding psychology of risk and behavior finance is an important, necessary addition to the theory and practice of modern finance.

According to research calculation, the efficiency of an investment portfolio is highly dependent on systematic factors (interest rate, exchange rates, other macroeconomic independent variables). With most readily available ratios, Sharpe for the period 1995-2005 > 5 times the Sharpe ratio for the period 2005-2015/20.

The paper findings result concludes that for the period 1995-2005, the industry enjoyed sufficient investment return from efficient allocation of portfolios: More Risk or More Capital was the mantra for the period. Further, the paper arguments that we entered into a new phase, 2005-2020, with insufficient return, and asset allocation to increasingly non-efficient portfolios; to meet the same financial goals, investors need to assume more risk and to invest more capital. Stable, negative correlation between fixed income and equity instruments was the rule in the post-crisis microenvironment. The regime shift in the financial markets out of central banks euphoric quantitative easing has made this diversification rule of uncorrelated bonds and stocks, less efficient. With yields expected to rise, long term bonds are less efficient as diversification instruments, shorter duration bonds look more efficient.

Financial markets have entered an era of yield deterioration (pandemic yield famine), with insufficient return - i.e., today’s investors need more risk and more capital to meet the same old goal of financial stability and prosperity by sacrificing the now consumption for the future investment and so for the real protection of purchasing power of their investment and retirement investment portfolios. In the new economic order of hyper monetization, the new era of financial capitulation against this apparently overwhelmed forces of tangible underperformance of active investment, inefficient asset allocation and high risk low return portfolios, the era of Ecclesiastes Finance14: for the same expected return, we need to assume more risk and to invest more capital. But in the new word of Ecclesiastes Finance even this hedged possibility has only a limited degree of probability. Without trust, honesty, transparency, best practice and putting the client interest first, investment performance is void of social appreciation and sustainability - an Ecclesiastes view of the word, pessimistic and unavoidable, hopeless, futile and vain.

14. Conclusions
(BiFi – abbreviation from Behavioral Finance)

(PsiFi – abbreviation from Psychology of Finance)

(Internet Investing – this expression encapsulates the trend of investment management and investment analysis profession on the last decade. Financial and investment services clients are becoming more sophisticated and more dedicated on doing their own research, on subscribing and using the information available on the internet and finally using internet brokers for their transaction-only based services. Next generation of financial services clients will try to use less of outside, professional service. This will change dramatically the landscape of the industry)

(Emotional Intelligence and Investor Behavior Paperback, 2009, by John Ameriks, Tanja Wranik, Peter Salovey. A survey of Vanguard IRA and 401(k) investors show that investors who score highly on tests of emotional intelligence (i.e., the ability "to recognize and use emotions productively") exhibit behaviors (e.g., the use of low-cost fund options) correlate strongly with good investment performance)

(Bodie, Zvi; Alex Kane; Alan J. Marcus. (1989); "Investments"; Irwin; p 342)

(Active investment management underperformance, preponderant for large, blue chips. This capitulation against this apparently overwhelmed forces of tangible underperformance of active investment, inefficient asset allocation and high risk low return portfolios - Ecclesiastes Finance).

Bibliography


