Investments: Contrarian Money Management

What Is Contrarian Money Management?

By: Joe the Investor

The term “contrarian investing” has been made famous which is the idea of buying securities when other people are selling them, and selling securities when other people are buying them. The premise is that people tend to buy equities at high prices, which means they end up paying too much. The reverse is true when people are selling, which means they get paid too little because they sell when prices are too low. This tendency has led to the expression of “buy high and sell low” as opposed to the formula for making money which is “buy low and sell high”. These tendencies tend to persist because people tend to invest with their emotions rather than the facts. When feelings are at their worst, this is when the compulsion is highest to make a decision and relieve the pain. Unfortunately, this is opposite to when money is usually made, which is when nobody else is investing and the uncertainty and the pain tend to be the highest. (1)(2)(3)(4)(5)(6)

The Typical Process

What about “contrarian money management”? In this case, people tend to make financial decisions when others are making them, instead of when the benefits are the highest. Here are some examples to illustrate the idea. At Christmas time, very few people are thinking about investing because there are other things on people’s minds, like the holidays and shopping. Once January hits, the mindset switches as tax season and RRSP season looms for the next few months. Suddenly decisions that were put off all year have to be made now. Due to resolutions, the idea of making a budget becomes popular. Another example is the summer season. Very few people want to worry about money when they are vacationing, or enjoying nice weather. Once the fall season arrives, these same people are trying to make many decisions about what stocks to buy and when. These are examples of making decisions when everyone else makes them. Is this important? On the surface, it doesn’t matter when you make your financial decisions. However, like contrarian investing, people are influenced by their feelings, and will only act when pain is maximized. What kind of pain am I talking about? The pain of being left behind, standing out from the crowd, or of inaction. If all of your friends are buying Apple stock as an example, would you be compelled to buy Apple stock as well so as not to get left behind? If this is how you invest, this is subject to poor decision making because you are not buying Apple because it is a good stock, but because of popularity. The same thing holds true with financial planning decisions. Are you buying an RRSP because everyone else is doing it? Are you doing a financial plan on April 30 because your accountant is warning you of tax issues if you don't? Are you opening a TFSA in March because the advertising everywhere is talking about it? If you answered yes, are these decisions right for you?

Popular Opinion

Your financial decisions should be made because you are ready to make them. These seasonal tendencies or popularity contests would be better used as times to think over what you already have and review your decisions that are already in place. Why does this matter? If you are making decisions only because "this is the time of year to do this", you will likely be swayed by popular opinion instead of what is important to you. Popular opinion will serve the average person, which is really a statistic, since no person is average most of the time. As an example, if you asked 100 people what their salary was, you would get answers ranging from zero up to $100,000. If the average was $50,000, would that describe everyone? There would be many people above and below this average, and only a tiny amount of people who actually made $50,000. If all of the popular opinion focused on someone making $50,000, this would not apply to most individuals, but it would be relevant for looking at 100 people as a group.

When you look at people's investing habits, you will find that most people lose money on their investments and invest with their feelings instead of what will benefit them. An extension of this idea is that people will buy things that are not suitable for them because they don't know themselves as well as they think. As an example, someone will keep a volatile stock until they lose money, and then lose sleep over it because they are losing money. If you knew that the risk was too high, you would not be in that stock. Take note that I am not saying that you would never lose money. I am saying that you would never lose sleep because you understand what risks there are and if money is lost, you understand the consequences and life will go on.

Money Management For its Own Sake

How do you manage your money so that you are getting the best results for you? You need to ask yourself what you are trying to achieve with your money. You will need to ask yourself this question every so often because needs will change over time. If your long term goal is wanting to save up and buy a house, then whatever you are doing should lead you to that goal eventually. If you find you are spending more money than you make consistently, then this goal should be revisited. If you are investing money in one account, but are losing more money on debt in another account, you are getting farther from your goal.

Contrarian Management

When making financial decisions, ask yourself what you need. This can be done at any time of year and for any reason. If you are seeing advertising to contribute to an RRSP or a TFSA, do your homework. These products are made for certain situations, and they may not apply to you. They may apply to you at some point but not in this particular year. You may have to do something different if it suits your needs more appropriately than the average. Use these seasonal indicators to remind you of what to consider, but don't let them drive your decisions blindly. Understand why you are doing what you are doing. If you have a professional to help you, allow them to explain to you why such and such a strategy is suitable for you. If you cannot understand them, you may need a new approach. Make decisions that are useful whether you feel good on that particular day or whether you don't feel good on that particular day. This is a way of checking whether emotions are driving your decisions, or reality. There will be an element of comfort required in decision making, and sometimes an element of faith in the unknown. Comfort and faith are different reasons than compulsive decision making, or greed induced transactions. By doing things on your own time, you are better able to assess decisions from a neutral standpoint, with less influence from forces that may not suit your interest.

Contact me, Joe Barbieri by email at joetheinvestor.today@gmail.com, or by telephone at 647-286-8020 for an independent consultation on what these options are. **Note: This site is intended for people who want to learn about the world of investments and how to research for themselves. If you would like to buy or sell investment products, or specific advice on investment products, tax or legal issues, please consult your investment advisor, accountant or legal counsel.**

Sources:

1) http://en.wikipedia.org/wiki/Behavioral_economics
2) https://www.fidelityworldwideinvestment.com/middle-east/news-insight/behavioural-investing/default.page
3) http://www.investmentpostcards.com/2010/03/12/interview-james-montier-on-behavioral-investing/
4) http://news.morningstar.com/classroom2/course.asp?docId=145104&page=1&CN=
5) http://bigthink.com/ideas/40833
6) http://newsroom.bmo.com/press-releases/bmo-psychology-of-investing-report-canadians-lett-tsx-bmo-201211280837495001