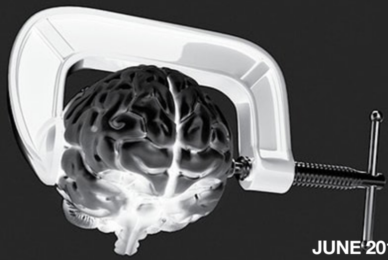
How your brain flushes cash down the drain



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Ultimately, only two things drive financial markets - fear and greed. Albeit that the AREIT market has bounced off its lows, the AREIT index is down ~ 4.25%[1] since the market peak in August 2016, it's the former rather than the latter driving property trust prices over the past 10 months or so.

The reason is that investors have been fearful of missing out on the "Trump trade", the rally in riskier equities due to Trump's proposed stimulatory policies in the US. They are also fearful of holding interest rate sensitive stocks like AREITs in a rising rate environment. The Solution? Sell property trusts. Buy risk.

Let's ignore the divisions and the emerging US political fiasco that may stymie much of the Trump agenda. Let's also ignore the emerging view that interest rates may not rise after all, which has seen US and Australian 10-year bonds actually retrace recently. Instead, let's examine why investors get fearful, because their fear is your opportunity.

Human behaviour is driven by emotions, which are the subject of much academic research and analysis. Behavioural economics (the application of psychological insights into human behaviour to explain economic decision-making) is a well-studied field producing valuable insights for investors.

Research has focused on the "rationality" of investment decision-making, or lack of it, in the context of risk and uncertainty. Often, the greater the uncertainty, the greater the fear and the greater the risk of overreaction. Call it "money brain" if you like.

The good news is that many of the risks that our brains expose us to (see How our brains lose us money) can be minimised. The bad news is that despite this, many investors fail to realise the ways in which money brain impacts their decision making, including:

- Constantly overestimating the upside and the downside, but especially the downside;
- Having excessive confidence in what we think we know;
- Having an inherent inability to acknowledge the full extent of our ignorance; and
- Appreciating our tendency to irrational decision making.

How does this lead to mistakes? Well, overestimating the downside occurs because painful experience leaves a bitter memory and that taints our future expectations. In over-emphasising loss we often miss the upside. Excessive confidence in our knowledge can also lead us to discount uncertainty and potential threats. Because we make decisions based on incomplete information we end up courting the downside.

The human tendency towards irrationality and making investment decisions without rigorous peer review is a sure-fire way of making these mistakes, which is why all investors should work towards overcoming their innate psychological shortcomings.

But it isn't easy, nor is it cheap. Humans learn best from mistakes and in investing that means losing money to learn a lesson. The alternative is to trust an expert to take the emotion out of decision making. Delegating your investment decisions to a dedicated manager with a team of experts empowered to challenge each other should lead to improved investment performance.

Personally, I'd like to think that's the case with APN's AREIT Fund, which has delivered a total return of 15.45%[2] per annum since inception to 31 May 2017 compared with the AREIT Index return of 12.82%[3] p.a. over the same period.

If you choose a strategy that avoids excessive risk you can minimise many of the classic dangers in decision making so clearly explained by behavioural economics. By keeping a simple focus on income, not seeking excessive capital upside and explicitly investing to protect yourself against the downside, you can overcome money brain.

That's how APN approaches investing on behalf of its clients. Our track record suggests it might be a sensible strategy for other investors, too.

1 XPJAI as at 20 June 2017
2 Fund inception 19 January 2009. Returns after all fees and expenses. Assumes distributions are reinvested. Investors' tax rates are not taken into account when calculating returns. Past performance is not an indicator of future performance.
3 S&P/ASX 300 Property Trust Accumulation Index.

APN Property Group

A specialist real estate investment manager

We actively invest in, develop and manage real estate and real estate securities on behalf of institutional and retail investors. APN's approach to real estate investment is based on a 'property for income' philosophy.

Established in 1996, APN's listed on the ASX and manages $2.4 billion (as at 31 December 2016) of real estate and real estate securities. APN trades on the ASX under the code 'APD'.

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