Behavioral Finance

Arbitraging Human Emotion

Daniel Bakalarz
Co-CIO, Managing Partner

UNISON
ASSET MANAGEMENT

Understanding Behavioral Finance is foundational to becoming a good investor in the long run.

UNISON

Three types of investing edges:

Informational → *"I know something you don't."*

Analytical → *"I understand this better than you."*

Behavioral → *"I have more control over my emotions."*

Informational advantages …

exist when an investor:

knows more about a business / industry than most market participants.

are gained by:

Scuttlebutt / investigative journalism.

Example:

Uber’s unit economics.

UNISON

Analytical advantages ...

UNISON

exist when an investor:

can process information better than most market participants.

are gained by:

Special degree / Higher Ed (e.g., CPA)

Example:

77% (388) of S&P500 cos. adjusted 2022 income.

35 GAAP losses resulted in 14 adjusted gains.

Source: Bloomberg

Behavioral advantages …

exist when an investor:

can control their emotions better than most market participants.

are gained by:

The right temperament (emotional awareness)

Example:

1. We are more likely to impulse spend when highly emotional.

2. Fins SB LVIII champs

UNISON

Why is Behavioral most sustainable?

Informational
+
Analytical

Ubiquitous

i. Internet
ii. Social media
iii. Now, AI

Behavioral

Immutable

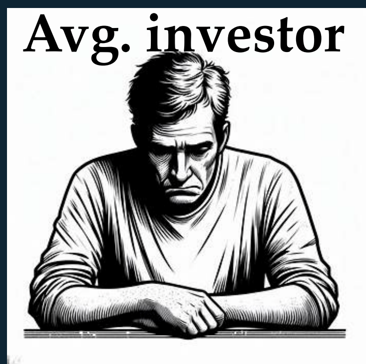
Mismatch theory.

Fight / Flight → *impulsive / quick response to a perceived threat*

Mate selection → *pretty people tend to be more successful*

Behavioral → *diabetes and heart disease*

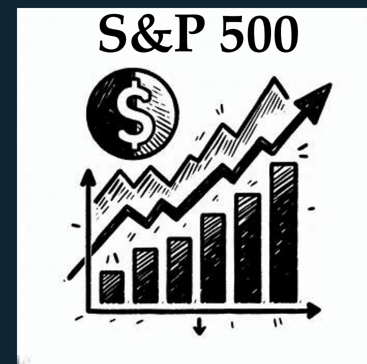
The average investor consistently underperforms the indexes.



20-yr CAGR = ~4%

$1,000 = $2,191

<



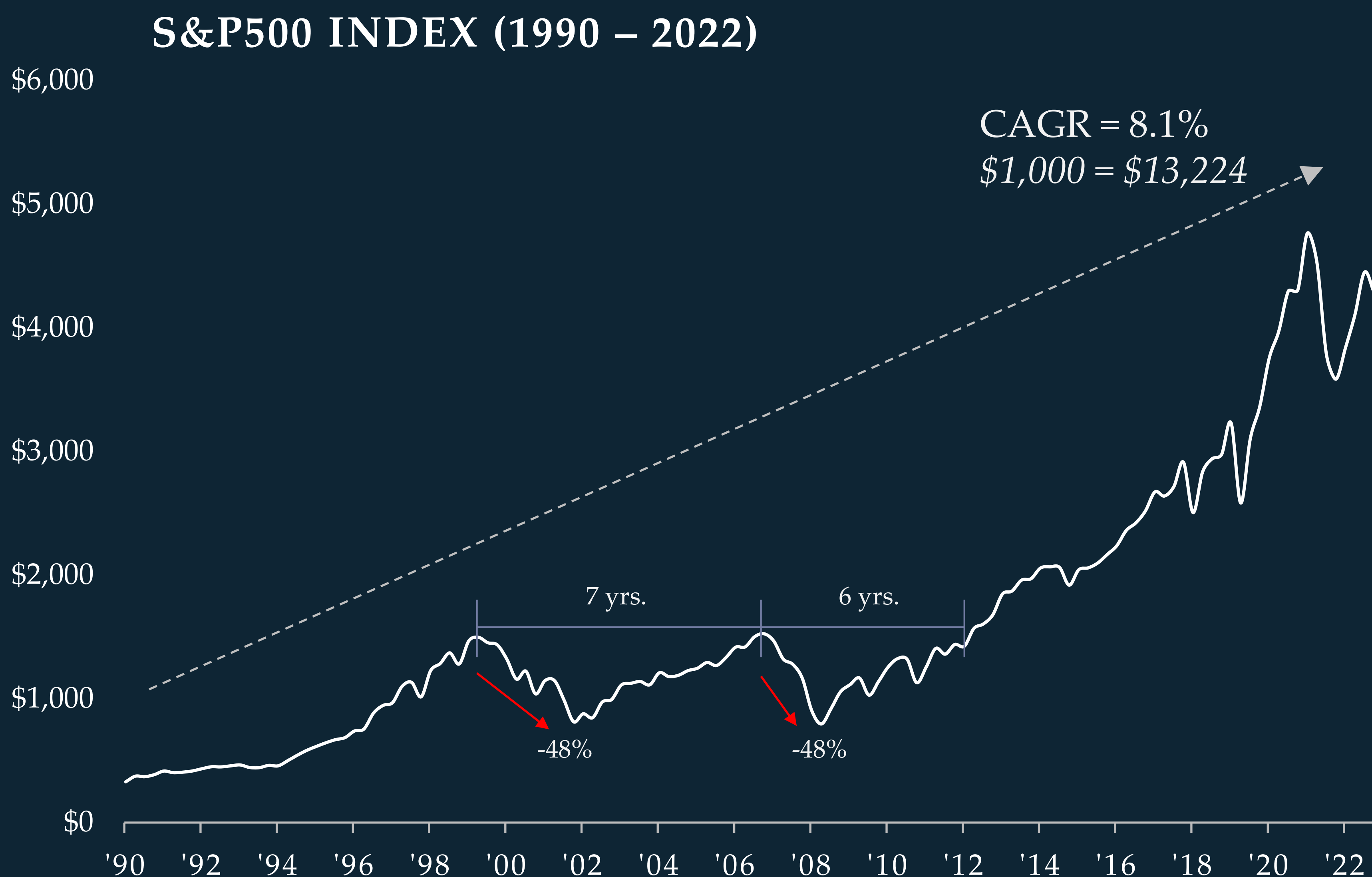
20-yr CAGR = 8.1%

$1,000 = $13,224

Source: J.P. Morgan

Investor psychology is mostly the reason.

Investing is hard. Very hard.

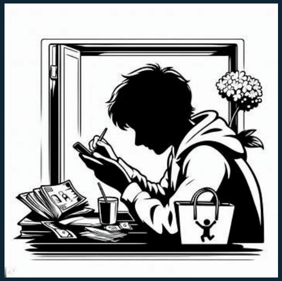


UNISON

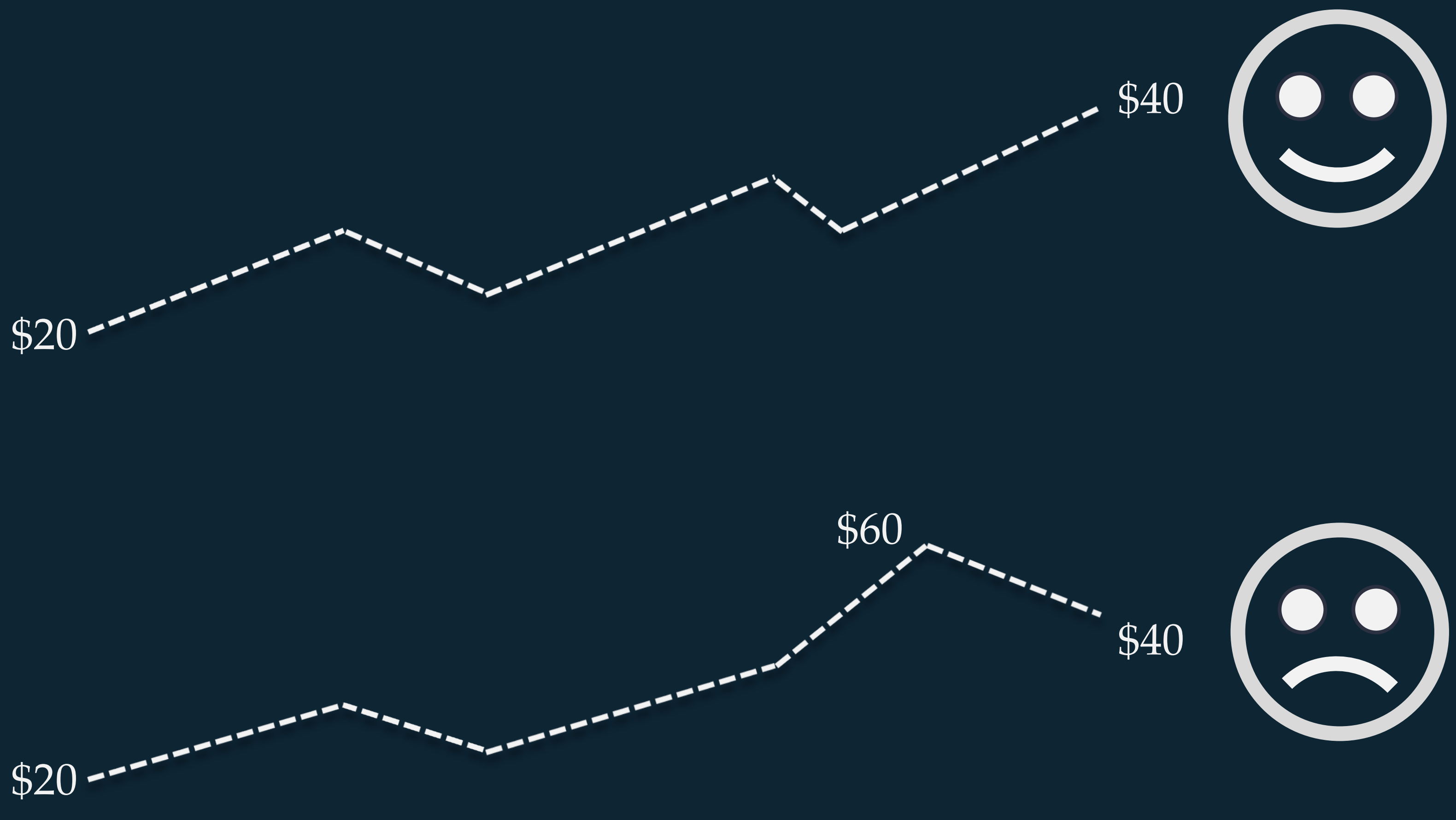
Two common mental pitfalls:

Loss-aversion: our losses are felt more acutely than gains.

Overconfidence: we tend to overestimate our abilities.



Biases make us sensitive to relative changes more than absolute outcomes.

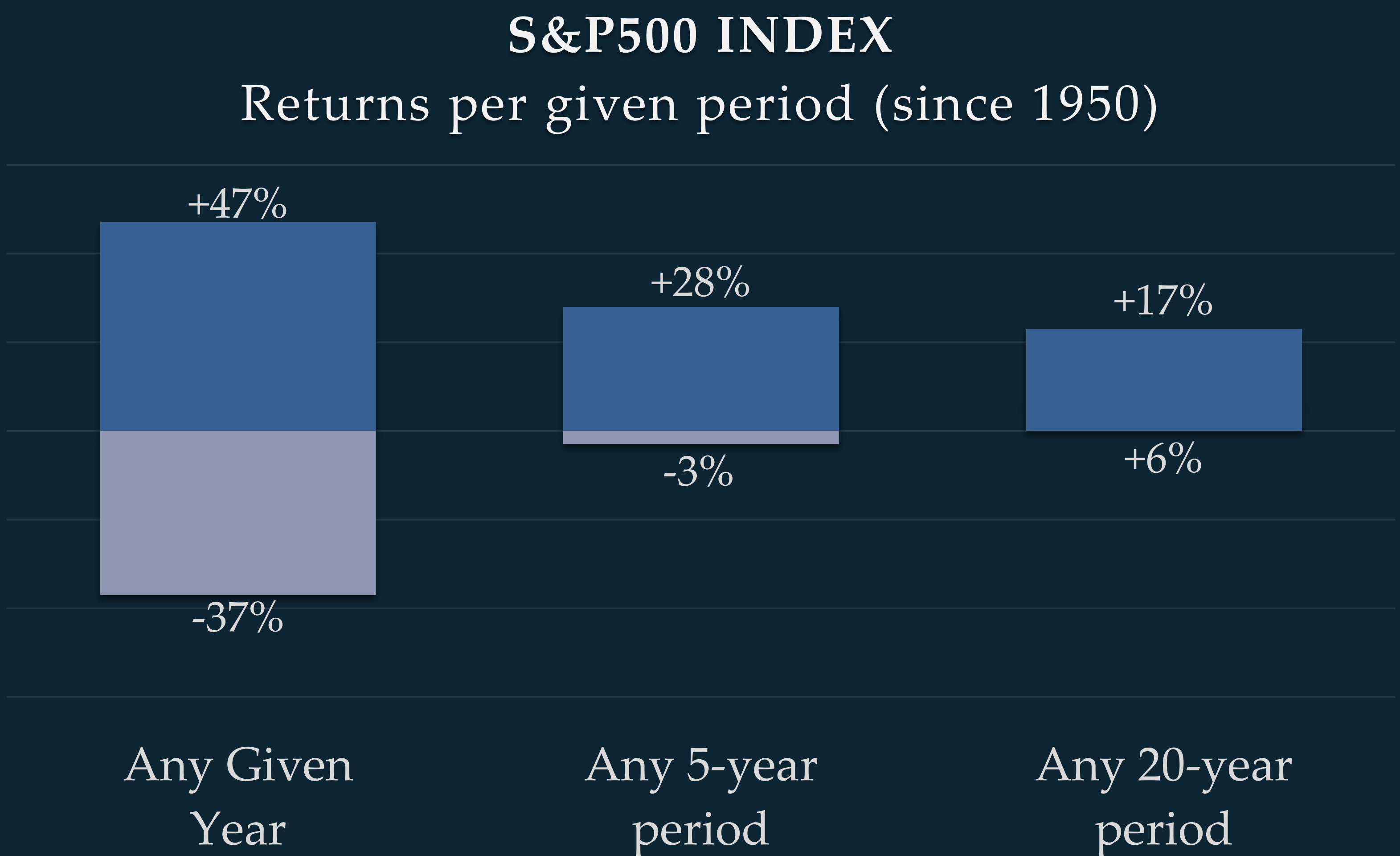


They also turn us into overactive investors.

Source: Dresdner Kleinwort Macro research

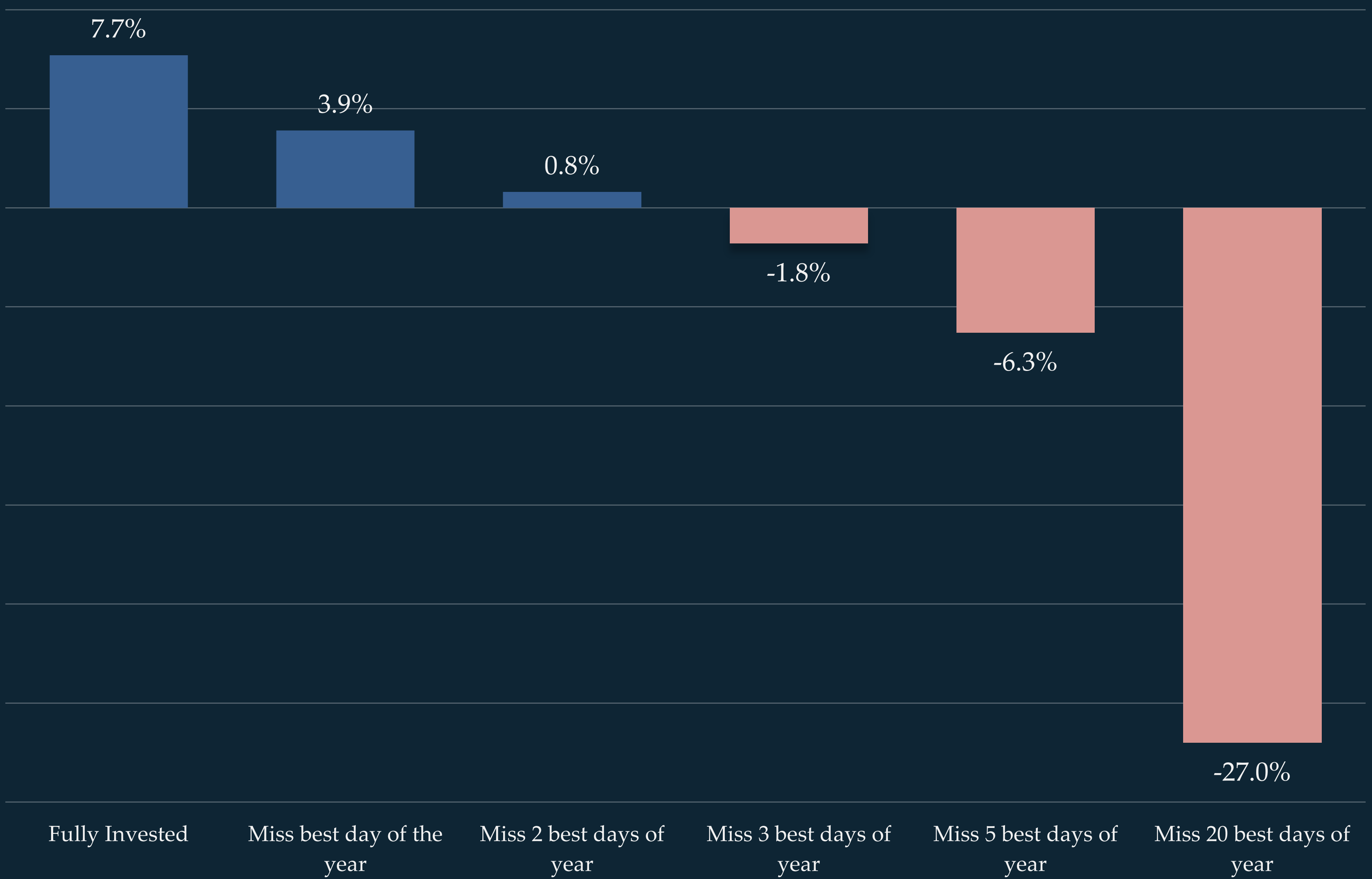
UNISON

The fastest way to get rich is to go slow.



UNISON

Time in the market > timing the market



UNISON

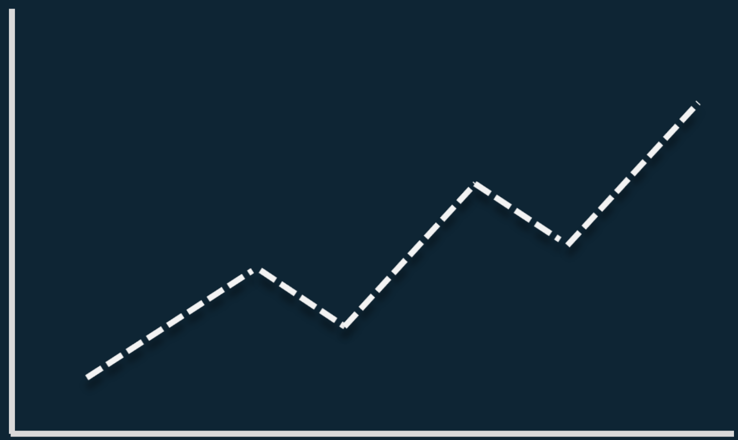
$100 doubling 10 times

Compounding Tax Free	Taxable at 25%
$1.00	$1.00
$2.00	$1.75
$4.00	$3.06
$8.00	$5.36
$16.00	$9.38
$32.00	$16.41
$64.00	$28.72
$128.00	$50.27
$256.00	$87.96
$512.00	$153.94
$1,024.00	$269.39

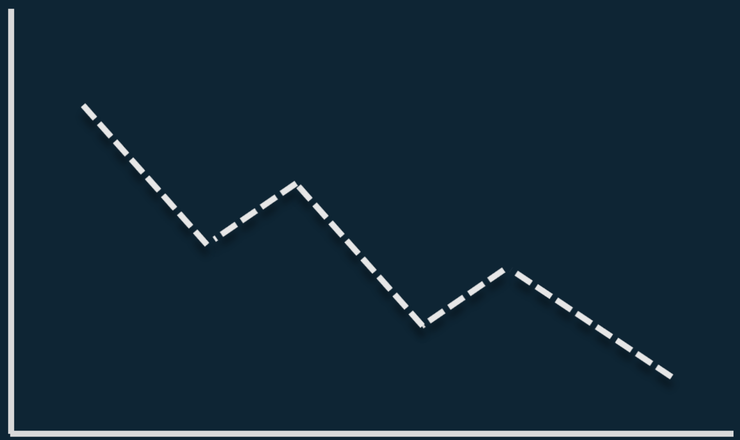
UNISON

Your portfolio is like a bar of soap. The more you handle it, the smaller it gets.

Develop the right mindset.



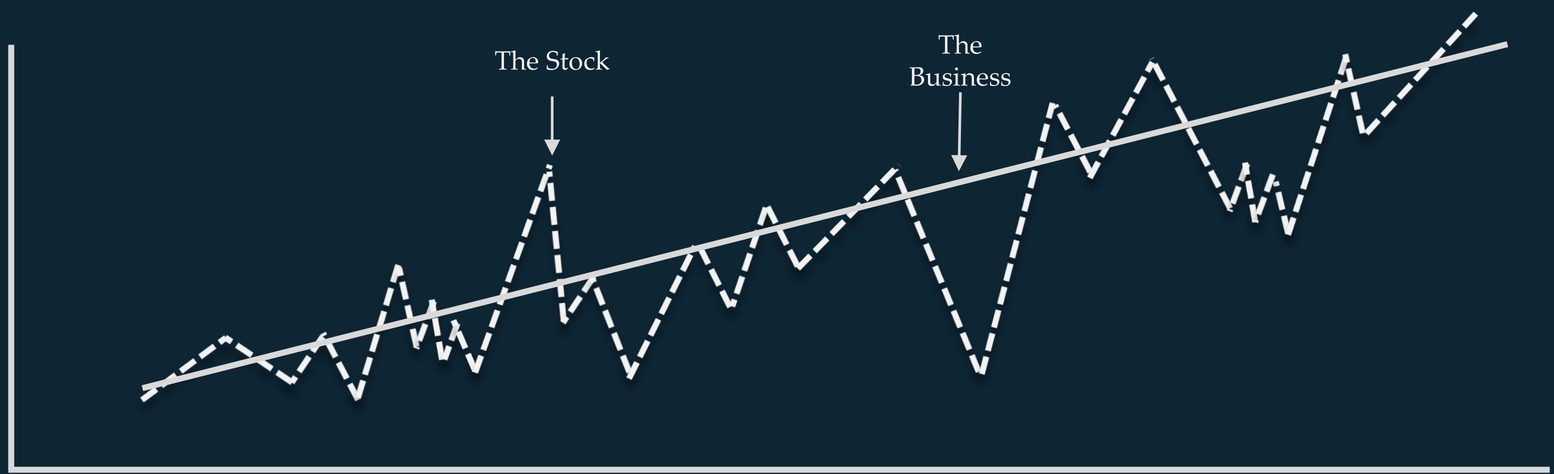
"Hurray!
My net worth
went up!"



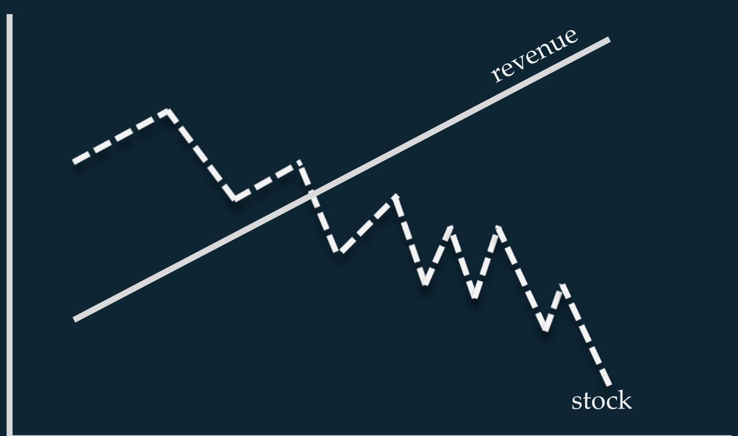
"Hurray!
My favorite
stocks are
on sale!"

UNISON

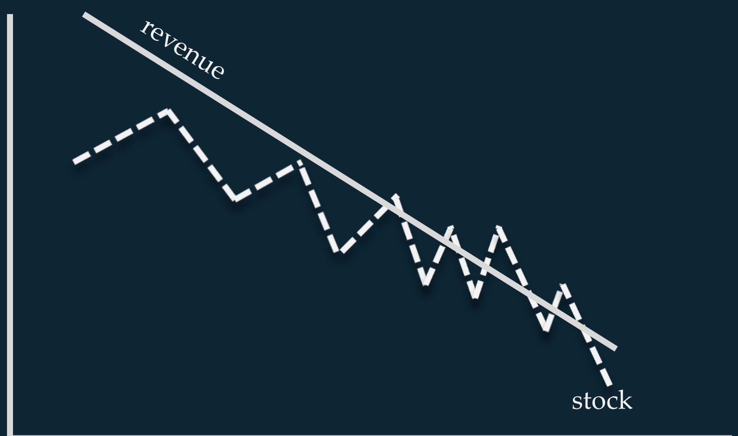
Know the difference between a stock and a business.



Buy damaged stocks.



Avoid damaged businesses.



Systematic Processes over Specific Goals.

"I want to own a great business at a good price." > *"I want to make $100k betting on stocks."*

Effectiveness over Efficiency.

"Widespread fear is my friend." + *"Personal fear is my enemy."*

In closing…

Buy good companies.
Don’t overpay.
Do nothing.

UNISON