DON'T BELIEVE THE HYPE!

WE'D ALL LIKE TO HIT ON THE NEXT BIG INVESTMENT THING AND MAKE OURSELVES RICH, BUT WE'RE MORE LIKELY TO GET IN LATE AND LOSE OUR SHIRTS – SO WHY DO INVESTORS JUMP ON THE WRONG INVESTMENT BANDWAGON?

Words:
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WHY ARE WE, as investors, so susceptible to hype? We read endlessly about the need for diversification and balance in investment portfolios – and yet time and again money floods in to certain sectors, often after the clever money's been made.

Is it a case of investors chasing stellar returns and overlooking the risk? Or are they being suckered by fund providers throwing their marketing budget behind what's in favour at any given time?

Then there's the get-rich-quick cryptocurrency bandwagon – seen by a vast majority as speculation rather than investment. There's no shortage of warnings about chasing the money, so why do we repeatedly make the same mistakes in chasing the latest hot theme?

According to Andy Prosser in Brooks Macdonald's Investment Office. "In theory, there's nothing stopping any particular sector becoming overvalued. Throughout history, there have been bubbles in tulips, shipping, railway companies, cotton, Japanese equity, technology stocks and real estate, among others."

Frances Watson, Partner at Mourant Ozannes, takes a similar line, but does see some common denominators. "All sectors are capable of hype, but where you have a new asset class, there's more susceptibility. There's far less historical data at hand to sufficiently weigh up the risks."

The tech boom of the late 90s and early noughties would be a prime example of this. A vast number of dotcoms with no track record of earnings had hugely inflated valuations based on the 'potential' of whopping great profits in a 'new age'.

Of course, potential itself is worth nothing – as many investors soon found out. To illustrate the carnage of the tech

crash, you need look no further than the dramatic collapse of the techMARK 100 index. Created in November 1999 to make it easier for investors to spot fast-growing technology companies, the index hit a peak of 5,753 at the pinnacle of the dotcom boom, but by May 2002 had fallen below the 1,000 mark.

IMPULSE BUYING

The speed at which these valuations rise creates a 'must buy' impulse that only serves to inflate prices further. "The sectors most susceptible to hype are those with inflated values and those with a novelty factor," says Martin Bamford, Chartered Financial Planner with Informed Choice. "When a sector rises in value quickly, our brains trick us into believing they can only continue to rise."

When it comes to the new or 'novelty' element, consider the Dutch tulip mania of the 1630s, where rare variations of the tulip flower were prized so highly as status symbols that one single bulb was selling for the equivalent of a luxury house in Amsterdam's most fashionable district.

The tech bubble may not have hit the same levels of absurdity as tulip mania, but there was arguably the same wishful thinking based on a new phenomenon. Was there an element of greed in there too?

Perhaps greed is too simplistic an explanation. Prosser suggests it was more a case of being afraid to miss out on what appeared to be a gilt-edged opportunity.

"Investors see other people making money from a certain sector – like bitcoin or technology stocks – and they dislike the idea of someone else making money faster than they are. They also want to avoid the potential regret they'd feel by not investing and watching from the sidelines as prices continue to rise.

"This fear of regret pushes more money into the sector, fuelled by the hopes of further 'easy' gains, and often without the necessary research on the investment or

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the risks being taken," he continues. "All of this further fuels the bubble, until rationality eventually takes hold and the bubble bursts."

All of this begs the question: does the hype cause the sector to rise, or does the boom in the sector cause the hype? Justin Modray, a financial adviser with Candid Money, believes it's a combination of the two. "Share prices might rise due to fundamentals, then investors jump on the bandwagon, pushing up the price beyond what's probably realistic," he explains.

MEDIA FRENZY

The media is hardly blameless in all this. During the tech boom, newspapers were packed with stories about dotcom millionaires, and their personal finance sections full of features on how to make money out of tech – typically placed next to full-page advertisements of tech funds.

Bamford believes marketing departments have a lot to answer for. "Marketers are very good at exploiting human emotions. They know what makes us tick and what will push our buttons, especially when it comes to the emotive subject of money.

"If a particular fund provider needs to push their fund, then a decent sized marketing budget is all that stands behind investors and their hard-earned cash."

He agrees with Prosser's point about the fear of missing out – and this has been especially apparent during the recent crypto-mania. "Anyone with half a brain cell can see that bitcoin et al have all of the attributes of a pyramid scheme. Yet the prospect of getting rich quick is too much to resist for some investors.

"Others exploit this by selling the tools, courses and schemes needed to profit from cryptocurrency – they know they can make more by selling the shovels than selling the non-existent gold."

So, while the amateur investors are

falling for all the hype, what about the investment professionals? Frances Watson believes that while fund managers might participate in the hype to make money, they are seldom sidetracked by all the media noise. "It has to be the professional investors who are creating the market. But they will realise it might be a bubble and have an exit strategy."

Andy Prosser agrees that the professionals are less susceptible to hype, but also that wisdom can desert anyone at any time. "Even some of the best and most famous thinkers in history have lost vast sums of money by falling victim to the latest fad. Sir Isaac Newton lost almost all his life's savings when the South Sea Bubble burst in 1720, before allegedly complaining: 'I can calculate the motions of the heavenly bodies, but not the madness of men'."

Almost all investing decisions are made by humans and nobody is immune to behavioural mistakes. But, as Prosser explains, professional investment managers do have the advantage of being able to observe market behaviour every day over a long period of time. That, combined with decades of academic research on the subject, makes them better placed to understand how human behaviour can feed into markets and affect asset prices.

You'd think that, with all of the information and research available on the internet, personal investors might be able to make a more informed decision. But has the introduction of easy-to-access, online trading platforms been a curse rather than a blessing for those individuals? They can follow a trend and get in quickly, conducting little or no background research on the stocks they are buying.

But it's harsh to blame the online infrastructure for poor investment decisions. After all, as Watson stresses, platforms facilitate investment and that's a good thing. And while technology allows the amateur investor to access a huge amount of information and analysis, it's their decision whether to use it or not.

Given that institutional investors make up roughly 80 per cent of total assets under management in the UK (according to the Investment Association), retail investors have far less of an impact on prices than institutions.

Institutional investors may identify and intensify the hype by continuing to pump money into a trending sector – be it biotech, mining or telecoms – but they will often have a clearer idea when to leave the party. It's often the amateur investor who fails to see the exit signs and takes the biggest hit when reality bites.

Behavioural investing comes into play here. Along with regret aversion and the fear of missing out, humans also have the tendency to extrapolate recent returns and imagine they will continue further into the future, known as 'representativeness bias'.

As Prosser explains: "Persistently strong short-term returns can often tempt further inflows, on the misguided idea that those returns are more likely to continue further into the future. Rationality can sometimes take a back seat when faced with the notion of getting rich quick."

The fact that many fund management teams use an investment committee to stress-test a strategy gives them an advantage over the individual investor who may not have a sounding board other than social media – which often creates more noise and irrational thinking anyway.

So how do you avoid the hype? Bamford suggests the answer is to create a plan on day one and then stick to it, regardless of what the markets do and what new opportunities come along.

He concedes that as a financial planner, convincing clients to remain focused is a tough challenge. "Choosing a suitable asset allocation model to meet future financial goals, and populating this with suitable funds, isn't the hard part of the job anymore. Convincing investors to stay invested when markets are volatile, or calming them down when they're tempted to invest in the 'next big thing' takes a lot more work." ■

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HOW TO AVOID GETTING SUCKED IN

- If you're buying on recent performance, take the time to understand what's caused this and whether it's sustainable.
- Ensure you're comfortable with the risks involved – chasing high rewards usually means taking high risks.
- Check the investment's potential liquidity – can you get out in a hurry if need be?
- Don't bet your shirt, only invest a modest part of your overall portfolio so a loss won't wipe you out.
- Is the investment regulated by the Financial Conduct Authority? Unregulated investments offer little or no protection should things go wrong as a result of fraud or suspicious activity.