The psychological analysis

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The psychological analysis

- Human element is present in the process of investment.
- Investment decision is subjective decision and is determined by human emotions.
- Compared with fundamental and psychological analysis it is only margine way of analysis.
- Fundamental analysis focuses on
  - Intrinsic value
  - Factors that determine this value
- Technical analysis
  - Analysis of past and current capital market development to derive future development
- The interest of technical and fundamental analyzers is focused on security.
- The interest of psychological analyzers are focused on behavior of investors on the capital market.

The psychological analysis

- The Subject of research is human being, human factor in the process of investment and impulses that evoke particular investment action.
- The basic idea
  - Mass psychology

LE BON MESS PSYCHOLOGY

- The starting point of Le Bon mess psychology
  - Analysis collective soul
- This collective soul establishes in the place
  - where is some group of people
  - and some event occurs that people are under mess psychology.
- Personal characteristics of individuals are put down and replace by collective way of thinking.
- In mess psychology the dominant role is in the short time period played by instincts.
  - Rational level of the mess is low, lower than is rational level of particular individuals in mess.

LE BON MESS PSYCHOLOGY

- General characteristics of mess
  - Vehement variability of spirit and sensibility
    - Investors inspired very easy for every attractive idea. It is very easy to convince them about attractively of particular investment.
    - Wave of optimism control whole mess.
    - Reason is in mass put down.
    - Dominant role is played by feelings.
  - Facileness of mess
    - Mess is fed by stories about easy, quick, above-average profit.
    - Mess is not able to differ what is illusion and what is reality.
    - Mess is not able to take into account what is probable, possible and impossible.

LE BON MESS PSYCHOLOGY

- Exaggerate and simplified feelings of mess
  - Feelings of mess tend to develop in extremes.
  - Mess
    - Uncritical love, or
    - Reject
- Intolerance and authoritativeness of mess
  - Mess hates criticism of mess idea and is aiming to spreading of advocate of this idea.
  - There is only one way why mess leaves this idea, only if the mess gets new, more promoting idea that takes turn last idea.

LE BON MESS PSYCHOLOGY

- Moral of mess
  - Moral level of mess is very low. Moral and ethics values are not adored by mess
  - Mess does not know moral and ethical responsibility, does not know misdoubt, does not analyses for and against do not take into account the possibility of punishment.

Kostolany investment psychology

- Initial point
  - Dividing of all capital market subjects in two categories
    - Speculates: 10 % of participants
    - Players: 90 % of participants
  - Particular continuity with Le Bon mess psychology because
    - The majority of investment – category of players represent mess with characteristics and behavior.
  - Speculates are strong personalities and they are immune against mass psychology.
  - In long time period speculates are more successful than players.

Kostolany investment psychology

- Speculates – firm hands
  - Characteristic of speculates
    - 4 G – idea, patience, money, luck
      - Gedenken, Gedult, Geld, Glück.
    - They are able to resist of mess psychology
    - They decision is based on relevant factors
    - In main trend in capital market
      - 2/3 of trend against main trend
      - 1/3 of trend with harmony of main trend
    - In investor experience there is very difficult to decide
      - When to start against main trend activity
      - How long to stay in these activities
    - Presumption for this successful behavior is in 4Gs
    - The main problem of Kostolany theory application is that it is based on
      - Native ability
      - Luck and accident

Kostolany investment psychology

- Players – shaking hands
  - The majority of investors
  - The activities in capital market are controlled by an afford to
    - Get high revenues in the short time period
  - They are not able to analyze situation in the market
    - They copy behavior of other subjects
    - Buy if other bought
    - Sell if other sold
  - But they behavior is delayed and they buy in case of high prices or sell in case of low prices

Kostolany investment psychology

- Activities of players are danger capital market because
  - They behavior is unpredictable
  - They behavior is not explained logically
- Kostolany:
  - *Speculates are happy if won and if the winning was based on calculation that was despite of the others expectation correct. The fact that their calculation was correct is for them more satisfy that the money they earned. But players are different if they won in same rare situation. They boasted about they winning but they were silent in the case of loss. And after every winning they think that are financial genius.*

Kostolany investment psychology

- Dividing of market in players and speculates with typical framework of behavior and actions has one important reason for analyzer – psychologist
  - He is able to find out which group of investors holt the most of the securities in particular time. It means he is able to investigate technical composition of the market.
  - According to situation in the market these is possible to derive probable tendencies in the future.
  - It the most of the securities is holt by speculates it is known as a oversold.
  - It the most of the securities is holt by speculates it is known as a overbought.

Kostolany investment psychology

- The technical composition of the market is based on
  - Analysis of stock exchange rates
  - Analysis of the volume of trade
- If stock exchangerates and volume of trade are rising
  - Movement securities form speculates to players because only players buy in case of rising security rates
  - Market becomes overbought
  - Market is high risk and danger because the majority of securities are in the hand of subjects that deal emotionally under mass psychology

Kostolany investment psychology

- If security exchange rates are declining and volume of trade are rising
  - Movement of securities from players to speculates because speculate are buying in the case of low security exchange rate
  - The proof of security movement is rising level of trade volume
  - This market is called oversold

Kostolany investment psychology

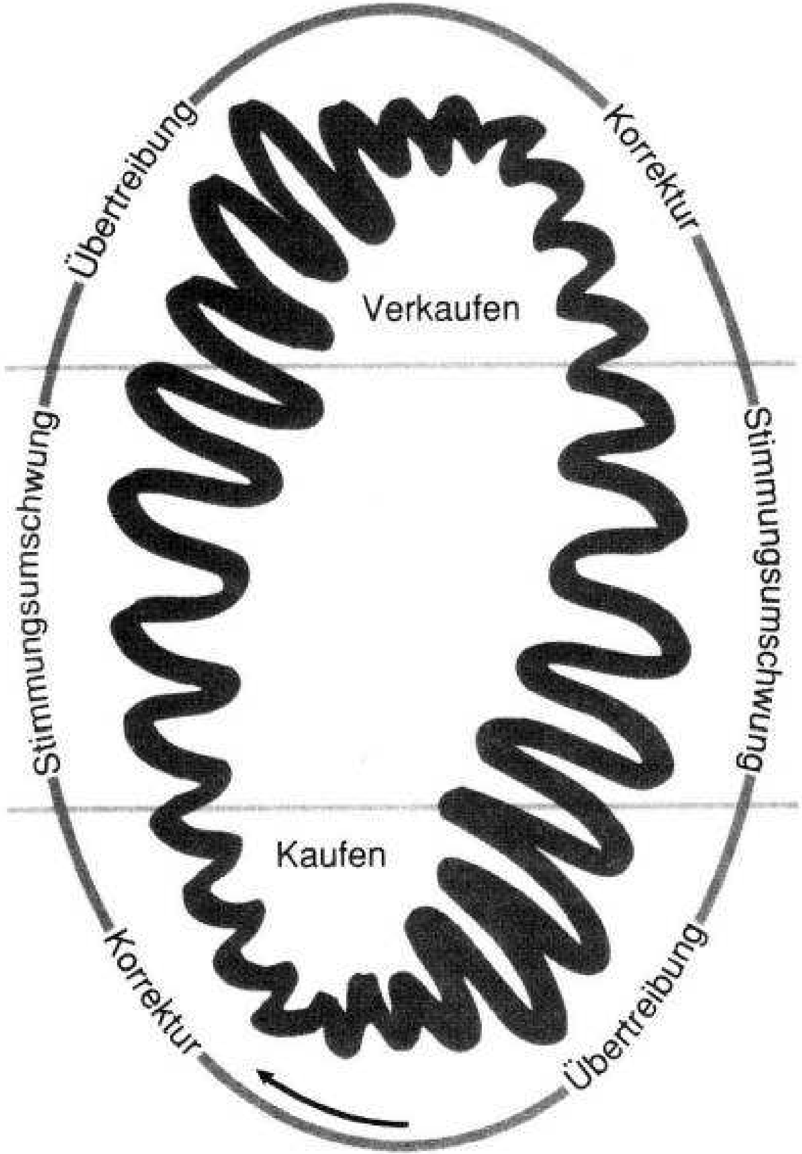
- If exchange rates are declining and volume of trade are declining as well
  - It is an evidence that speculates despite of declining stock exchange rated did not start to buy
  - In this situation these is expected negative development in capital market
  - Speculates are
  - expected sharp decline in the future

Kostolany investment psychology

- In security exchange rates are rising and volume of trade are declining or stagnate
  - Two possible scenarios
    - Players are controlled by pessimism or players do not get any positive information that starts they activities
    - Or player are illiquid they have no money to they investment activities
  - If we know in which hands there is the majority of securities or in which hands are securities moving it is possible to derive in which phases of cycle is stock exchange.
    - Cycle of stock exchange is repeating of three phases
      - Phase of turnover or correction
      - Companion phase
      - Overstatement or switching phase

Kostolany investment psychology

- Cycle of stock exchange is pictured as a nutshell


Übertreibung
Korrektur
Verkaufen
Stimmungsumschwung
Stimmungsumschwung
Kaufen
Korrektur
Übertreibung

Kostolany investment psychology

- If we start in point Y – one day of stock exchange development
- Stock exchange rates are in minimum value, players are controlled by pessimism
- Turnover of this situation is started by some positive unexpected information
- Players are controlled by this positive information and pessimism is replaced by optimism
- Growing phases started
- Volume of trade, profit of companies, stock exchange rates are rising
- This phase is called phase of turnover or correction of rising trend

Kostolany investment psychology

- Optimism is spreading and it is a reason why the rising stock exchange rates is not interrupted in the next phases of cycle.
- Activities of players force security stock rates in higher and higher levels
- Rising of stock exchange rates is followed by growth of profit
- Capital market is in companion phase of rising trend.

Kostolany investment psychology

- Profits and stock exchange rates continue in their growth, market is controlled by euphoria and enthusiasm.
- But this situation is turned out if players get negative, unexpected information. This information changes their emotions.
- The capital market is in the last phase of rising trend – switching phase.

Kostolany investment psychology

- Because of negative information spreading optimism of players is declining.
- The pessimism is spreading through mess.
- Rising trend is replace by declining trend that starts with its first phase called phase of turnover
- The price level is high, inflation rate is rising, the risk is rising in the capital market
- Interest rates are rising free financial resources are more expensive.
- Liquidity of player is declining.
- Risk is rising and in the market emerges negative prognoses and expectation.
- Players are lower their demand and stock exchange rates are declining.

Kostolany investment psychology

- Panic is spreader over players
- They multiple their security sales it induce next decline of security exchange rates.
- Capital market is in the second phase of declining trend.
- In the last phase in switching phase the panic reaches its peak. Players are selling last securities that they owned.
- This phase take till all securities are not in hands of speculates.
- Declining trend is near its end, near point Y.
- Turnover is evoked by some positive information and whole cycle will start again.

Kostolany investment psychology

- Only speculate that dispose by all unique characteristics (4G) is able to distinguish
  - Kind, start and end of particular phases and
  - derive the most suitable time of sale or purchase.

Test of speculates

Kostolany investment psychology

Number of A: 11-14

You are focused on safeness.

If you earn money you have only one care how to stick them together.

Your investment strategy must be focused on precise estimations of revenues.

You should hold your money in bank account, maybe you can choose time deposits or short-term bonds.

Kostolany investment psychology

Number of B: 11 – 14

You are typical speculates.

You do not prefer long-term investments.

You are interested in stock exchange, you are looking for new information and react to them in the moment.

You are waiting for the right moment.

You are not investor you are speculates.

But if you do not have a time for your investments invest your money in saving account.

Kostolany investment psychology

Number of A:10, or

Number of B: 10

- You like adventure but you ale so need some risk buffer.
- Your risk must be exactly calculated.
- Investment products according to your profile
  - middle-terms bonds
  - blue chips, or
  - government securities

Epstein and Garfield Investment Psychology

- Ira Epstein
- David Garfield
- At the end of 20th century with questionnaire for 140 retail and 175 professional investors
- According to results 6 kinds of investor profiles
  - Very important is the role of the money in investor life.
  - For every investor is important to find out its personal, true relation to money to be able protect yourself against money.

Epstein and Garfield Investment Psychology

- Masked investor: Money makes me proud and the others will be proud to me
- Depressed investor: Money makes me happy
- Revenge investor: With money I can pound those that pounded me
- Fussy investor: Money avoids breakup of my personality
- Paranoid investor: If I have money I can not be hurt
- Conflicted investor: Money makes me the winner but what happened if I lose?

Masked investors

- You wish to be an investment superstar
- No, doubt, you are extremely competitive: winning is everything.
- Often, you wish to be someone other than yourself: someone bigger or better.
- Your investment performance is directly related to how you feel about yourself – a successful trade makes you feel like a million bucks, an unsuccessful one is caused for self doubt.
- Like a professional athlete you accept the risks of the game and carefully calculate the odds.
- When you take a risk, it's a calculated one – you are sufficiency disciplined to avoid throwing it all away an a single play.
- Each play must be a winning move.

Depressed investor

- You trade but there is a little preassure in it. You invest but whether you win or lose you are consistently unhappy.
- If you lose it just confirms your feelings of inadequacy.
- If you win, you reproach yourself for not having won more or you attribute it to luck.
- You seldom give yourself any credit.

Revenging investor

- You can not get enough of the investment/trading scene
- You read every financial newsletter you can get your hands on.
- Investment talk gets you excited like little else.
- In the back of your mind, you believe that investing can have a profound impact on your life and can not turn it around.
- Perhaps you are suffered some serious losses but it doesn’t damped your enthusiasm a with.
- You came back for more, hoping you will get even and get better.

Fussy investor

- Here, you are wrapped in the process, in the details of investing.
- Are the orders placed correctly?
- You check and double-check.
- Are they in the right price?
- In this cluster people religiously pore over each trade as it is a piece of scripture.
- You will not find anyone in this group with paper spread over desk or randomly filed.
- Everything is filed alphabetically, logically, consistently.
- The lose track of the details of a trade is a mortal skins.

Paranoid investor

- In this cluster people keep one eye on their broker and other eye on the market.
- You can not be too careful.
- You are always looking for a way to minimalist risk.
- If you have a system you do not totally trust it, no matter how well it's done.
- You rarely, if ever, take a flyer on a new or chancy stock.

Conflicted investor

- If you fit the description of the conflicted investor, you are probably anxious about your trade.
- Even when you are on vacation your are thinking on trade.
- When you think about you're your trading, you feel good about in one minute but bad about it the next days.
- Some days you decide you should invest a lot of money and hold your strategy other day you think you should invest a less money and a try a new approach.