

Betting on stocks? Don't bet on winning

Wong Wei Han

Over-confidence is clouding the judgment of investors and leading them to systemic errors in their investment strategies, according to a leading local academic.

Associate Professor Fong Wai Mun of the National University of Singapore Business School told *The Sunday Times* the tendency of investors to think they know it all is why the market is rife with stock betting, a lack of diversification and excessive trading, all against the tenets of prudent investments.

"Individual investors have much less information about the markets (than professionals), but most of them are also affected by an over-inflated confidence in their own ability," Prof Fong said. "One clear symptom of this is that investors do not diversify their portfolios, instead putting all their wealth on a few stocks because they're 'confident' the bet will make money."

When that happens, such investors expose themselves to residual market risks that have been statistically proven to yield negative returns on average – much like buying a lottery ticket, he said.

"This is also why Singapore investors have a distinct preference for penny stocks, which have low prices and skewed returns, just like lotteries. To illustrate the outcome of these biases, we need only look at what

happened in the penny stock crash in 2013."

About \$5 billion in market value in Asians, Blumont and LionGold was wiped out within the first hour of trading on Oct 4, 2013, prompting the Singapore Exchange to suspend the counters and curb trading in them for two weeks.

The crash came after the stocks were pushed to extreme highs – by over 560 per cent between the start of January and the peak on Sept 30 in 2013 in the case of Blumont – on the back of speculation that was not linked to any market or corporate fundamentals.

"This is a classic case of herd mentality, a bandwagon effect that led to a quantum jump in market caps for no apparent reason. And as you can see, all it takes is a small change in senti-

ment to prick the bubble," said Prof Fong, who specialises in finance and investment.

He noted these problematic behaviours during research for a book he was writing last year. Aside from over-confidence, his research also indicates that investors have a tendency to read market trends when there really are none.

"When a stock has been rising for three days or weeks, what will happen next? Many will see a 'momentum' and forget that, statistically, day-to-day and even week-to-week price movements are entirely random, and betting on random outcomes is essentially just gambling."

Prof Fong, who was an investment analyst at OCBC before he joined NUS in 1986, hopes to see more investors cultivating more sustainable market habits.



False confidence

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"First, you want to diversify. Spending about 5 per cent of your wealth on a few lottery stocks is not necessarily a bad thing, but if these take up a large portion of your portfolio, then you are in trouble. Also, try to trade as little as possible. When you are trading on 'market noise', then the chance of getting a positive risk-adjusted return is actually very low.

"For layman investors who have little time or market knowledge, one good approach is to buy index funds or exchange traded funds."

These track an index such as the Straits Times Index.

"And don't limit yourself to STI ETFs – try to diversify across the sector because markets are not always in sync."

Life-cycle funds managed by professionals are also a good way to invest as investors do not have to constantly worry about asset and risk allocation, he added.

But taking chances is not automatically wrong as long as the risks are not taken blindly.

"I don't think the behaviours I described are inherently 'bad': It's all about balance. There's nothing wrong with having 5 to 10 per cent of your portfolio on active trading, for example.

"I do that once in a while, too – and I have paid tuition fees many times. Be ready to pay more if your strategies involve a lot of betting and trend chasing."

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