PENNY WISE PARAG PARIKH

"What belongs to us is always more valuable than what belongs to others"

You call your stockbroker to ask him the price of stock "X" which you are holding and wish to sell. He quotes a bid and offer price Rs 99/100, which means you will be able to sell it at Rs 99 and buy it at Rs.100. You ask him to sell 100 shares at a higher limit of Rs 102 and anxiously wait for the market to go up. You also ask him the price of stock "Y" which you wish to purchase. The bid and offer price is Rs 65/66. You can sell at Rs 65 and buy at Rs 66. You ask him to keep a limit of Rs 63 and buy 100 shares, and wait for the market to go down.

No, sorry, I am not talking about you. We all are subject to the same behaviour when we deal in stocks. Why do we always want more than the market is quoting even when we want to sell? Similarly, why do you want to pay less when we wish to buy? Why do we assume that the market quotes are wrong? This happens due to the behavioural anomaly of "Endowment Effect": the value of a thing increases when it becomes a part of one"s endowment. What belongs to us is always more valuable than what belongs to others. That explains our behaviour when we buy and sell stocks. We always believe that the market is high when we wish to buy and low when we wish to sell.

DON'T LOVE STOCKS

'If you are holding stocks that have done very well, be aware that endowment effect does not get you into the decision paralysis mode'

Why do analysts go to analyst meet of companies? Firstly, they want to find the job opportunities which will offer them higher salaries. Secondly, if you are holding the stock of that company, you want to know more about it and hear good things from the management. Thirdly, you need to cover the stock for your organisation and make a report about it. Fourthly, cocktails and dinner follow all such meets.

Now let us analyse the above scenario. Would a company call its analyst meet to talk bad about itself? No. Do the analysts not know that the company will only talk about its positives? Yes. Analysts who are holding the stocks go for the feel good factor caused by the confirmation bias. They make their buy recommendation reports. Analysts who are not holding the stocks will buy and also make positive reports on the company after hearing positive news. Endowment Effect is at work.

On the other, endowment effect could deter an investor from taking decisions. Endowment effect could lead to investors getting married to their stocks. This is very pertinent today where we have seen a bull phase for the last four years. Investors would be reluctant to sell their holdings as these stocks have given them handsome returns. Recall the tech boom and the bust. During that period, the investors were so wedded to their tech stocks that they were unable to sell when the tide turned. If you are holding stocks that have done exceedingly well, be aware that endowment effect does not get you in into the decision paralysis mode.

(The author, chairman, Parag Parikh Financial Advisory Services, specialises in behavioural finance. He will write every second week of the month on behavioural finance)