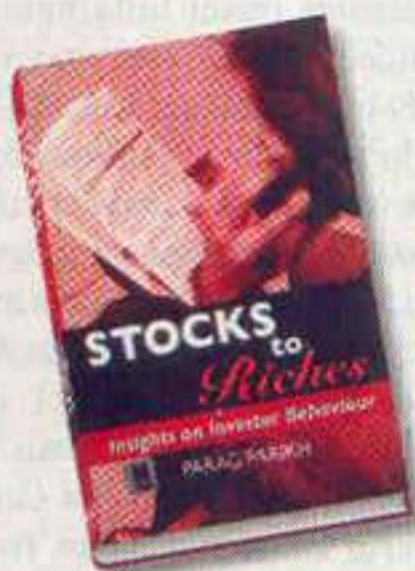


What We're Reading Now



Stocks to Riches: Insights on Investor Behaviour

By Parag Parikh
Tata McGraw-Hill
114 pages; Rs 195
Rating ★★★★★

Let's say you have an aunt whose generosity is matched by her liking for mathematical games. When you tell her you're getting engaged, she offers two choices of wedding present; (i) an outright Rs 50,000 gift or, (ii) a 70 per cent chance of getting Rs 1 lakh, with a 30 per cent risk of getting nothing. What would you take? The certain Rs 50,000? Um. Bad choice.

Let's try another test. Say you accidentally ruin your aunt's favourite Kanjeevaram sari, and you offer to get her a new one. But she has a gleam in her eye, and two more options; (i) replace it for Rs 7,500 or, (ii) flip a coin. If you win you pay nothing. Lose, and you pay her Rs 18,000.

You thought a coin toss would save you? Oh dear.

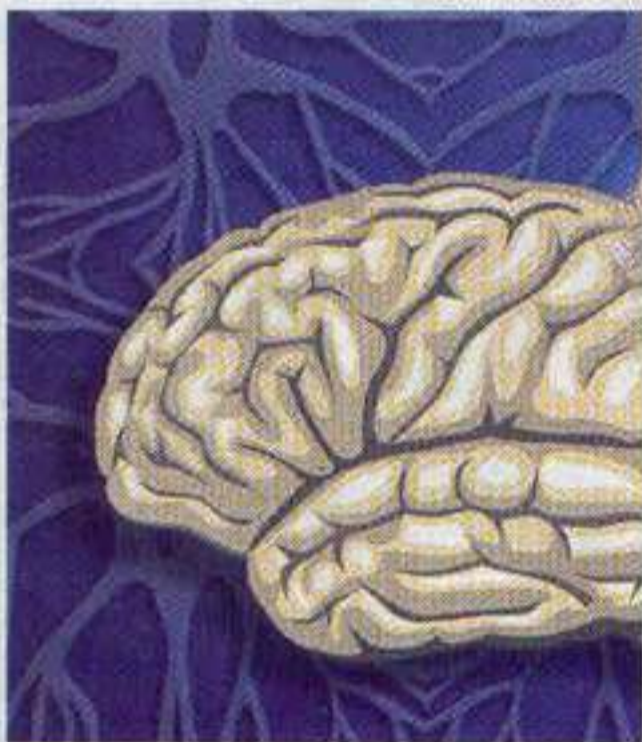
Probability theory tells us you skipped a likely gain of Rs 70,000 for Rs 50,000, and then took a likely Rs 9,000 loss instead of a Rs 7,500 expense. You aunt may love you, but you won't be managing her portfolio any time soon.

Still, you're not alone in letting your fear of a loss ruin your grasp of risk. Millions of investors worldwide do it daily, and suffer. And until 1979,

when psychologists Daniel Kahneman and Amos Tversky published their path breaking *Prospect Theory: An analysis of decisions under risk*, few economists or finance gurus entirely sensed what anthropologists and other students of the "softer" social sciences have long known. Humans are complex, irrational creatures and our behaviour doesn't reduce to simple mathematical certitude. Yet prevailing economic theory based on the surmise that we engage in rational profit-seeking behaviour could not explain how we routinely—and repeatedly—make bad decisions over money.

But an understanding of our minds

Illustration: MANOJIT DATTA



**Respect the markets.
They are interesting
because we cannot
understand them.**

can. This insight would win Kahneman the 2002 Nobel prize in economics (Tversky had passed away in 1996). Along with the work of Gustave LeBon, Robert Shiller, Richard Thaler and others, it is the basis of behavioural finance.

This discipline is key to all matters monetary, and is especially important in volatile markets. In the last two

months, the BSE Sensex has gyrated over a massive thousand-point range, with no shortage of associated investing befuddlement. Amid such chaos the dangers of succumbing to the ways we naturally think become huge. It isn't just a matter of forgetting basic probability. There are other traps. For instance, we also regularly assume we know more than we actually do about money, let success make us overconfident, confuse speculation and investment and get paralysed in the face of opportunity. We aren't necessarily being stupid in doing this; merely seeking financial happiness. But even that old cynic Jean-Paul Sartre said if fooling yourself is the price of happiness it isn't worth it. And in a tricky market it doesn't help when our innate biases foil profitable investment.

This is why Parag Parikh's book is so timely. Parikh is one of India's best-known stock brokers and investors, and a respected financial commentator. In this volume he explains what every lay investor must know about the pitfalls inherent to their thinking. This should offer useful insights to professionals too. The quirks in our minds are not only a retail phenomenon; there's an institutional component in the wreckage of most financial bubbles.

But since he draws inspiration from a wide field including psychology and anthropology, it's intriguing that Parikh doesn't directly address gender. Studies indicate that men and women tackle investing somewhat differently, and disagreement on financial goals ranks among the most cited causes of marital discord. Perhaps that's a subject for an entirely new book.

Meanwhile, as Parikh says, "Respect the markets. They are interesting because we cannot understand them." But you can try to understand yourself, and in so doing, get more out of the markets. Which is precisely why you should buy this book today. ■

HARI MENON

READRIGHT:

★ Avoidable

★★ Interesting

★★★ Good

★★★★ Must-read