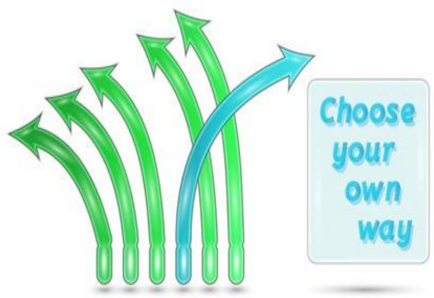
# If little Johnny jumps off the bridge, will you do it too?

Are you the black sheep? Do you like to buck trends? In the latest Oliver's insight, Shane Oliver discusses why a wariness of crowds is essential to successful investing.

Sometimes being at one with a crowd can be nice, e.g. at rock concerts it adds to the ambience and safety in numbers can provide comfort. However, when crowds turn they can be dangerous – you might get trampled! In fact a wariness of crowds is essential to successful investing.

The trouble with crowds from an investment perspective is sourced in investor psychology. It is well-known that individuals suffer from lapses of logic.

When many investors make the same lapses of logic at the same time as part of a crowd, the result is magnified. This is further emphasised via mass media, making a behaviour contagious.

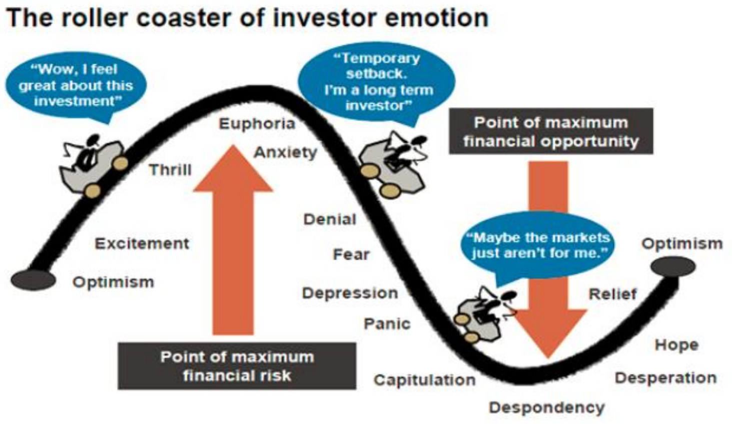



The means by which individual lapses of logic morph into collective views on markets include the general media, both traditional and on-line (where stories of sharp rises/falls in asset prices grab attention) and pressure for conformity via such mechanisms as industry standards, interaction with friends at dinner parties, BBQs, etc and monthly fund managers' performance charts & benchmarking (which discourage "risk" taking and deviation from the crowd).

During a bull market 'optimism' progressively gives way to 'excitement', then 'thrill' and eventually 'euphoria' as the actions of the thousands of investors push the asset class – be it shares, property, bonds or a currency ever higher in value. It is at this point that investors are most bullish. Unfortunately it's usually at this point that the market has become overvalued and with the crowd fully on board everyone who wants to buy has and so it only takes a bit of bad news to tip the market down.

When a bear market begins investors initially see it as a short term setback. But as 'anxiety' gives way to 'fear' investors eventually 'capitulate' and become 'despondent', selling their investments. However, the point of maximum crowd pessimism, when the crowd has sold and the asset class is cheap and unloved is the time when it starts providing its best opportunity for returns. It then usually only takes a bit of good news to start tipping the market higher.

This is demonstrated in the following graphic:




Source: Russell Investments, AMP Capital

So while it's impossible to drill into the minds of thousands of investors the behaviour of the crowd gives a great guide to investment market opportunities both at tops and bottoms. Tops are usually associated with some form of crowd euphoria and market bottoms are associated with mass despondency. So being a contrarian and doing the opposite to the crowd at times extremes makes sense.

But of course it's never that simple.

There are two points to note though. First there is a difference between what people say they are thinking (i.e. investor sentiment) and what they are actually doing (investor positioning). Both are a guide to where the crowd is at.

Secondly, negative crowd sentiment at market bottoms can tend to be associated fairly quickly with market bottoms reflecting the steep declines associated with panics as a market falls. But during bull markets positive sentiment or even euphoria can tend to persist for a while as it takes investors longer to build exposures to assets than to sell them. It may also reflect the tendency of share markets to rise more than they fall.

In conclusion there are several implications for investors. First, while it may feel uncomfortable, successful investing requires going against the crowd – particularly when the crowd is at extremes of bullishness and bearishness. For more information please talk to your Adviser or view the full article (below)

NOTE: this an excerpt of the full article 'Why investors need to be wary of crowds' by Dr Shane Oliver which can be found at http://www.ampcapital.com.au/article-detail?alias=/olivers-insights/February-2014/Why-investors-need-to-be-wary-of-crowds

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