

EXPERIENCE, MEMORY AND MARKETS

*"The four most dangerous words in investing are:
This time it's different."*

- Sir John Templeton

*I agree this crash may
not be exactly the same
as the previous ones,
but as Mark Twain
said, "History doesn't
repeat, but it does
rhyme"*

In the first week of March 2015, the Nifty 50 index in India crossed 9000 for the first time and touched an intraday high of 9119. Five years later (March 12, 2020), we are barely 5% away from that level. The NSE Smallcap 100 index is in fact 20% below the level it was 5 years ago. Amid the coronavirus scare and the talks of recession, the market sell-off has been broad based. Stock prices plummeted irrespective of the change in fundamental values of companies.

To get some sense of the word on the street, I spoke to a few of my friends who have been investing professionally since the early 1990s. The response was unanimous: *"I don't know where the markets will bottom. I haven't seen anything like this earlier"*. Those who were looking to take advantage of the fall during the first leg of the crash rescinded their views and wanted to wait longer before deploying their funds. Their statements surprised me. I wondered how someone who has been an investor for more than 25 years, has not seen anything like this before. The past two decades specially have seen a high share of volatility and crashes. Certainly, they have also read about the market crashes that happened in the last century. I agree this crash may not be exactly the same as the previous ones, but as Mark Twain said, *"History doesn't repeat, but it does rhyme"*.

In the previous note, I discussed Myopic Loss Aversion as one of the reasons why investors are not able to take advantage of market falls. Today I create a hypothesis, based on a concept of 'Two Selves' given by Nobel Prize winner, Daniel Kahnemann, to explain why people feel 'this time it's different.'

THE TWO SELVES

Daniel Kahnemann is the first psychologist who won a Nobel Prize for economics. In his book, 'Thinking Fast and Slow', he talks about how there are two selves to everyone - a 'Remembering Self' and an 'Experiencing Self'. He explains it with an example. One of his students approached him at the end of a lecture and told him about a symphony he had been listening to. "It was absolutely glorious music and at the very end of the recording, there was a dreadful screeching sound. And then he added, really quite emotionally, it ruined the whole experience". According to Kahneman, the student's experience was not ruined; it was the memory of the experience that was ruined. Though the student enjoyed those 20 minutes of good music, that experience did not count because he was left with a bad memory of it.

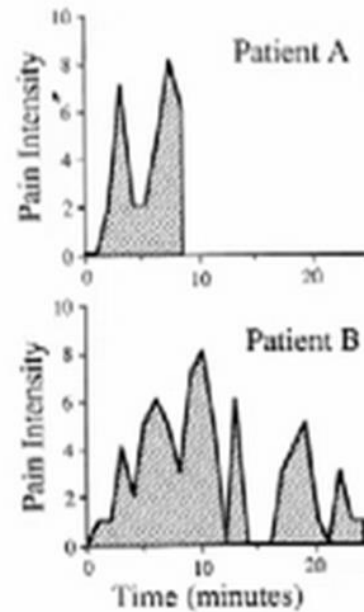
*The 'experiencing self'
lives in the present...
The 'remembering self'
is the one that keeps
score...*

The 'experiencing self' lives in the present. It's the 'experiencing self' that the doctor approaches when she asks, "Does it hurt now?". The 'remembering self' is the one that keeps score, and maintains the story of our life, and it's the one that answers when the doctor asks the question, "How have you been feeling lately?" The 'experiencing self' lives moment to moment; but not all those experiences make it to the memory. The 'remembering self' is a storyteller and keeps what we derive from our experiences.

Perhaps an example of a colonoscopy experiment conducted by Don Redelmeier (Physician and Researcher at University of Toronto) will help in understanding the concept better. The chart below shows the experiences of two patients undergoing a painful colonoscopy procedure. The patients were asked every 60 seconds to rate the level of pain they were feeling. For Patient A, the procedure lasted for 8 mins and for patient B it lasted for 24 mins. Which patient suffered more? Clearly the patient B suffered more as he endured the pain

Although the investors undergo the same fear and pain during every large down move, the story feels different

longer (shaded area is larger). However, when the patients were asked about how much did they suffer? Patient A had much worse memory of the colonoscopy than Patient B. When the pain was at the peak in the end, the patient retained a bad memory of the whole experience.



There are many areas where this concept of two selves applies. Take the case of parenting: Parents generally have a very good memory of raising their children. However, their day to day experience of raising them may not be very pleasant. How about holidays? If you had a great holiday but it ends with you losing your passport and wallet, the 'remembering self' will paint the story with quite a bit of pain.

HOW IS THIS ALL RELEVANT TO THE MARKETS?

Here is my hypothesis: a lot of investors have experienced investing during crashes in the past. They carry a memory of how crises are an opportunity to increase allocation towards equity markets. And how ultimately, they make great returns when the markets bounce back. At the onset of every new crash, these investors recall those memories. The 'remembering self' recites to them the story of how profitable investing during bad times is. However, the 'remembering self' has not captured all the moments of the past. The 'experiencing self' went through every moment of fear, agony and anxiety that comes with contrarian investing during the previous crashes. But most of these moments are lost and only the happy endings dominate the story.

***“There is nothing new
except what has been
forgotten”***

- Rose Bertin

During the current market slump, the ‘experiencing self’ is living the pain of a contrarian stance every day. And within a few days of fall, one feels things are different from what the ‘remembering self’ narrated. This time it’s different! Although the investors undergo the same fear and pain during every large down move, the story feels different. They are likely to feel that conditions were better the last time. The phenomenon is true for raging bull markets too. Even though investors carry the scars of participating in past bubbles, they are pulled into a new one with the catch phrase “this time it’s different”.

I believe investors who have participated in markets for decades have seen every aspect of the boom-bust cycle and they have the right learnings from those experiences. With the right temperament, they can take advantage of these cycles. They understand how this time it may feel different but with a deeper look it all too often is the same. “There is nothing new except what has been forgotten”- Rose Bertin.

**NIMESH CHANDAN****HEAD – INVESTMENTS, EQUITIES
CANARA ROBECO**

Nimesh Chandan is Head-Investments, Equities at Canara Robeco. He has almost two decades of experience in the Indian Capital Markets. Nimesh has been with Canara Robeco since 2008 and in his current role, he guides the equity team in providing a strategy for various equity funds. He is a keen follower of Behavioral Finance and has developed tools and processes which help improve the investment decision making process. He also conducts workshops wherein he presents the concepts of Behavioral Finance to investors and financial advisors under a series called 'The Money and the Mind'.

ABOUT STOIC INVESTOR:

The word “Stoic” is used to describe someone who remains calm under pressure and avoids emotional extremes. For the purpose of this newsletter we refer to the “Stoic investor” as an investor who is realist (avoiding extreme optimism and extreme pessimism), resilient (withstand difficult conditions) and rational (who acts with logic and reason).

Disclaimer:

*The information used towards formulating this document have been obtained from sources published by third parties. While such publications are believed to be reliable, however, neither the AMC, its officers, the trustees, the Fund nor any of their affiliates or representatives assume any responsibility for the accuracy of such information and assume no financial liability whatsoever to the user of this document. This document is strictly confidential and meant for private circulation only and should not at any point of time be construed to be an invitation to the public for subscribing to the units of Canara Robeco Mutual Fund (CRMF). **Please note that this is not an advertisement or solicitation for subscribing to the units of CRMF.** The views expressed herein are only personal in nature and does not constitute views or opinion of Canara Robeco Asset Management or Canara Robeco Mutual Fund. The document is solely for the information and understanding of intended recipients only. Internal views, estimates, opinions expressed herein may or may not materialize. These views, estimates, opinions alone are not sufficient and should not be used for the development or implementation of an investment strategy. Forward looking statements are based on internal views and assumptions and subject to known and unknown risks and uncertainties which could materially impact or differ the actual results or performance from those expressed or implied under those statements.*

***Mutual Fund investments are subject to market risks, read all
scheme related documents carefully.***