NOVEMBER 2011 ANNO III NUMBER 11

Telos PRIMO PIANO SCALA c

Jason Zweig is the investing and personal finance columnist for the Wall Street Journal. In his latest work, "*The Little Book of Safe Money*", Zweig faces the dilemma which troubles savers and investors workdwide. He has worked for *Money* magazine, *Time* and CNN.com. In 1995 before joining *Money,* Zweig was the mutual funds editor at *Forbes.* A frequent commentator on television and radio, Zweig is also a popular public speaker at such venues as the American Association of Individual Investors, the Aspen Institute, the CFA Institute, the Morningstar Investment Conference, and a lecturer at Harvard, Stanford, and Oxford. He sits on the editorial boards of the *Financial History* magazine and *The Journal of Behavioral Finance.* Formerly fluent in French and Hebrew, he can curse in Italian and accept hospitality in Arabic. Jason runs a website of financial advice and financial culture, which is 100% non-sponsored and self-financed: www.jasonzweig.com

## *Editorial*

What am I going to do with my savings? What if I resorted to my good old mattress? That, at least, won't betray me! Primo Piano Scala c focuses its attention again on the financial crisis, this time assuming the point of view of the small investor who doesn't know who to turn to and wonders: *after the hurricane that hit the global financial market, the breakdown of big investment banks, the collapse of stock and bond markets, how can I be sure that my money is in a safe place?* We then looked for someone who could provide a clear and comprehensive answer to this question, with the right dose of technical jargon and, above all, with a personal track record making him a credible source. It was precisely his credibility and his candid speaking that led us to Jason Zweig, a well-respected voice from the financial world who immediately gave us an apparently basic piece of advice: improving our awareness on the markets, on the professional intermediaries who work there, even more importantly on ourselves, would be enough. Still, it's not easy to achieve, particularly because of the variety of factors influencing our behaviour as investors: psychological factors such as our (unconscious) confidence that our instinct is more trustworthy than a careful analysis on a stock's fundamentals, or our perception of ourselves as prudent investors whereas risk propensity is, on closer look, widespread. Zweig does not hesitate when it comes to blame financial intermediaries, but tones down his criticism of them being the incarnation of evil: he rather considers their behaviour as stemming from *stupidity,* and (we would add) greed. A compelling interview indeed, but still flowing smoothly, unveiling the shape of the small investor who struggles in the complicated world of finance, his myths, his feelings and his jargon. Let us conclude with a little bit of pride. When Primo Piano Scala c asked Mr. Zweig for an interview, we were told that we had to wait for the WSJ authorisation. Understandable, we thought, since he is an important columnist and the WSJ may have exclusive rights. That was only partially true. The WSJ may only deny its authorisation if the publication submitting the request for an interview is not deemed by its editorial board as authoritative enough to host one of its names. Well, we passes its scrutiny!

*Mariella Palazzolo*

# **Jason Zweig.** Oh God, where did my savings go?

**Telos: In your 'The Little book of safe money' you provide investors with a guide on how to safeguard their financial future. Could you summarise your advice in a nutshell?**

**Jason Zweig:** To invest and make your money grow, you must take at least some risk. But you should never take risks that aren't necessary, that aren't likely to reward you, or that could give you losses you can't afford to suffer. You must be skeptical of the claims of anyone who promises safety or "high yield" without risk. And you must look for data on the past performance of the people who tried the strategies you are considering, it's the only way to see whether you should take these risks.

**The financial crisis severely hit the reputation of financial intermediaries. Do you think that this bad reputation is well deserved?**

Yes, absolutely.

There were three kinds of financial companies during the years before the financial crisis: 1) those that were honest and traditional and conservative, protecting their clients' money as if it were their own; 2) those that joined the juggernaut of rapid trading of risky assets, without fully realising that they were taking dangerous risks with their clients' money; and 3) those that drove the juggernaut, at least partly comprehending what they were doing, using massive amounts of borrowed money, suspecting that it could end in disaster and putting the interests of their own money ahead of their clients. The first kind of company, which we should call "wise," was very rare. The second kind, which we could call "stupid," was extremely common. The third kind, which we might call "evil," was also very rare. In finance as everywhere else in life, stupidity is common and evil is scarce. In normal times, stupidity can't badly damage the system, but in times of crisis, evil can almost destroy the system.

I will not name any of the companies in any of these groups, but they know who they are, and so do most of their clients. You need only look to see who used the most leverage, or borrowed money, to see who was stupid and who may have crossed over the line into evil.

There is nothing new in any of this. Every financial crisis in all of economic history has always been precipitated when leverage was piled on top of *hubris. Hubris* alone is usually not powerful enough to destroy investors and markets. Leverage alone isn't powerful enough, either. But put one on top of the other - as people always do when a mania reaches its peak - and disaster is inevitable.

*So, while the goal of investing is to buy low and sell high, the brain is built to tempt you into buying high and selling low. You will tend to be most excited and euphoric when you should, in fact be cautious; and you will likely be most frightened at the very moment when there is a big sales sign hung across the façade of the Stock Market.*

**With your book 'Your Money and your Brain', you gave an extraordinary contribution to bringing the principles of neuroeconomics to the understanding of a popular audience. Could you briefly explain us in which ways psychological determinants can influence the behavior of investors?**

You need to understand that your brain is a remarkably efficient machine for making rapid decisions about familiar stimuli. The human brain evolved to respond rapidly to risk. In a fraction of a second, the brain processes frightening stimuli like a lion, a snake, a spider...or a collapsing stock market or a national debt crisis. Your heart will race, your breathing will come fast, your muscles will tense, and you will be primed to run away from whatever scares you. This makes savers and investors over-react to bad financial news. On the other hand, the human brain also evolved to approach whatever is rewarding. Financial gains are processed by the same general circuits in the brain that also evaluate the presence of food, water…and sex. The hope of profit is fundamentally rewarding, and anticipating a profit may be even more rewarding than actually earning it. So, while the goal of investing is to buy low and sell high, the brain is built to tempt you into buying high and selling low. You will tend to be most excited and euphoric when you should, in fact be cautious; and you will likely be most frightened at the very moment when there is a big sales sign hung across the façade of the Stock Market.

**Italian investors are well-known for their high risk aversion, which traditionally led them to invest a large part of their savings in State bonds. What is your view on this behavioral tendency? Does it positively contribute to financial stability or is it ultimately detrimental in delaying the development of our financial system?**

I'm not an expert on Italy, but I do know that Italians are prodigious savers. That should be an asset for the nation, since many countries suffer from having citizens who don't save enough (the United States, for example!). Unfortunately, according to data from Elroy Dimson, Paul Marsh and Mike Staunton of London Business School, Italy has had the highest rate of inflation and the weakest currency among any of 19 major nations since 1900. In the long run, that has produced relatively low rates of return on stocks, bonds and cash. Anyone worldwide who has consumed goods and services produced by Italian companies knows that Italy can compete with the best corporations in the world. The problem isn't financial; it is political. (The same is true for the U.S., of course.) Italian companies and their investors will prosper when Italian governments begin to make policies that are beneficial for economic growth. Italy is rich in savings and in "human capital," or the talents of its people. Its debts should be manageable. It is its policies that are the problem.

**The reform of Financial Institutions has been lively debated in Europe and the U.S. over the last years. Can financial journalism, contributing to a larger understanding and awareness on the financial matters, act as a tool to re-establish financial stability from a bottom-up, rather than top-down perspective?**

I wish this were completely true, but I think it is only partially true. The public is more interested in financial matters than ever before, and financial journalism deserves some of the credit for that. But over the past century, there have been four financial crises in which global stock markets have fallen by at least 40% (adjusted for inflation). Two of them took place in the past decade alone. That certainly doesn't suggest that the public has increased its understanding and awareness. Instead of becoming more sophisticated, we seem to be more like sheeps than ever. The Internet in general, and now Facebook and Twitter in particular, may be spreading the contagions of fear and greed faster than ever before. It also may be easier for lies and misinformation to spread on the Internet than in the slower physical world.

I think the most important question that the public should ask is, "What is the base rate?" The base rate - a term used by psychologists and statisticians - tells you the likelihood or probability of an outcome based on a large sample of past events. The weather forecast uses base rates: "A 30% chance of rain today" means that on 30% of all the days in the past that were similar to today, there was rain.

Thus, when saving managers propose a plan to keep your money safe or to achieve good profits, you should ask: What is the base rate? Namely: how often has this strategy been used? Where is the published data showing how well it worked? Any better alternative?

Usually the people "selling" the ideas are not the ones who will be willing to provide you with the base rates. You will have to look elsewhere. But the positive side of the Internet is that almost all data can now be found online. Good financial journalism can help point the public toward those answers, or at least make it easier to find them. That is progress!

**Telos Primo Piano Scala c -** Direttore responsabile: Maria Palazzolo. Editore: Telos A&S srl Via del Plebiscito 107, 00186 Roma - Reg.: Trib. di Roma 295/2009 del 18 settembre 2009. Diffusione: protocolli Internet - Isp: Eurologon srl
www.telosaes.it - telos@telosaes.it