

Crosby, Daniel – The Behavioral Investor*Harriman House, 2018 [Finance]* Grade ★★★★★

This is a book with great ambitions. In the first sentence Daniel Crosby says that the aim for *The Behavioral Investor* is to be the most comprehensive guide to the psychology of asset management ever written. Dr. Crosby, a psychologist by training, is the Chief Behavioral Officer at Brinker Capital and a leading blogger and podcaster on the subject of behavioral finance – this is his forth book on different topics in this discipline.

Some fifteen years ago I fell in love with behavioral finance as it so obviously described aspects of investing and financial markets that traditional finance and economics didn't. Over time the interest has however started to wane since the academics in the area devoted their energy towards adding yet another insult towards the previously dominant efficient market hypothesis creating an ever growing list of interesting and quirky behavioral biases but no real practical applications for investors. According to the author "[...] *all this ends today, as we will take [these biases] and speak to the particulars of what they mean in the context of making money.*" I would argue that the aim of being the most comprehensive guide is reasonably well met for a book of "only" about 250 pages. With regards to fulfilling my wish of an applied behavioral finance investment method *The Behavioral Investor* unfortunately only gives fairly broad guidelines.

The author is well read in both academic literature and more practical investing books. Despite the author's learnedness the language is very readable and clear as Crosby's writing comes with a humorous and personal touch. This is a finance book without most of the technical finance jargon – although at times it instead contains some psychology terminology. Nevertheless, it's undoubtedly a very readable book.

The book is structured in four parts with the first outlining the sociological, neurological and physiological foundations to the biases investors exhibit. Then the author summarizes the many documented psychotically based follies of investors

into four primary tendencies regarding ego, conservatism, attention and emotion. Part three tries to list practical measures to overcome the previously described problems and finally the book ends with the author's "third way" of investing (as opposed to passive investing and active investing) called rules-based behavioral investing (RBI). Hence, the first half gives a background and the second half tries to apply the learnings in real life. Throughout *The Behavioral Investor* Crosby discusses most of all the psychological experiments and subsequent findings that a frequent reader of behavioral finance literature will ever have heard of but without it ever getting tedious.

RBI is as the name suggests rules based with a high base allocation to equities implemented through a combination of value and momentum quant based equity portfolios and with an overlay of valuation (Tobin's Q, CAPE etc.) and momentum (200-day or 10 month moving averages etc.) based rules for when to very occasionally lower the allocation of equities. The focus is to find a rational and evidence based methodology where the room for behavioral biases is kept to a minimum. Although this is only one of several good ways to manage money I personally think this is a great setup, but regrettably Cosby only gives a very fleeting description of what his RBI actually looks like. Further, the Achilles heal of the rational quantitative strategy is that it needs permanent money or else it will suffer redemptions at the exact wrong moment from its less than rational human investors.

If this is one of the first books you read on behavioral finance you are to be congratulated as it will surely be mind-blowing. If you have followed the area during its development, *The Behavioral Investor* is a very good inventory of current knowledge but it adds relatively little new. And perhaps it's a good thing that a best selling book cannot deliver a detailed best practice behavioral finance investing method as it is then up to me to develop it myself.

Mats Larsson, December 31, 2018