OLDER
But Not Necessarily Wiser

A Practical Guide to Aging & Investing

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THE SPEAKER

- Founder and Lead Principal — Cove Street Capital, LLC, a Los Angeles-based boutique institutional money manager with $1.1 billion in assets.
- 32 years' experience as a trader, analyst, and portfolio manager — a career spent trying to make new and interesting mistakes versus repeating the same ones.
- Paid $2.50 plus shipping in 1988 for Tversky and Kahneman paper, "Can Normative and Descriptive Analysis Be Reconciled?"
- I truly believe that behavioral finance — watching real human behavior and trying to understand why we do what we do — is infinitely superior as a way to make money rather than a process of concocting models and trying to fit human behavior into it.
- No advanced degrees or medical training — I will attempt to stick what is "practical" versus theoretical.
- Plagiarism is stealing from one, research is stealing from many. (See the bibliography.)
- Co-architect of Kylie Bronchick, Freshman, University of Miami Business School.

TODAY'S GAME PLAN

A Practical Guide to Aging and Investing

TOO YOUNG AND DUMB

SENILITY

Good news for today — I am 54, the optimum statistical age where my annual cognitive function decline meets my ability to conquer behavioral biases in investment decision-making.

PHYSIOLOGICALLY SPEAKING

1. Our brains are wired with tens of thousands of years of biological basis of behavior versus a few hundred years of organized stock market investing.

2. Hypothalamus signals glans to produces steroids (testosterone) or cortisols, which spread through body and brain to enhance or depress "reactions" — enables us to survive...and makes us lousy investors making the litany of behavioral finance mistakes:

- Availability bias
- Gamblers fallacy
- Overconfidence and expert judgement
- Anchoring
- Ambiguity bias
- Representativeness
- Loss aversion
- Frame dependence
- Hedonic editing
- Regret
- Money illusion
- Hindsight bias

FAST VS SLOW THINKING

THE LOW-T ADVANTAGE?

But as we get older, testosterone production decreases. So:

- Shouldn't this enhance our ability to be patient and rationally process the best we can through blizzards of potentially relevant data? ("Thinking Fast and Slow," Kahneman)
- Helps us physiologically avoid getting over-excited at tops or pessimistic at bottoms?
- Ergo — assuming an investor is not eaten on his way to his portfolio, why shouldn't some degree of aging be a positive for investing?

Good investing is "boring. " It is not a place to look for stimuli and testosterone replenishment. (Get a Porsche instead.)

One more thought: If the above is directionally correct, shouldn't a woman be running your portfolio?

PICASSO VS MANET

There are some forms of art, activity, and investing that are geared toward boldness, youthfulness, high energy.

» Venture capital, investment banking, leveraged currency trading. (Picasso)

Retirement investing is not one of them. (Manet)

» It is the end result of many years of planning.

» "Speed of thought" is more of a hindrance to retirement investing than a help. You would rather be slower to recognize a great idea than be the first to do something dumb.

» Thinking through a long-term and comprehensive plan.

» Sticking to it.

» Learning from mistakes and getting better.

In fact, is some form of dementia helpful for an investor? If people forgot to check their portfolio for 5 months, couldn't quite remember the name or number of their financial advisor, or couldn't find their remote to turn on CNBC, I am sure their portfolio would be better off.

BUT HERE ARE OUR REAL PROBLEMS NO MATTER WHAT THE AGE

BOUNDED RATIONALITY (Simon —1955)

» It is hard to figure out how much to save, how to invest , and what we really will need for retirement.

» Compounding, time horizon, tax implications are not innate.

» We do not act "model rational."

BOUNDED SELF CONTROL (Thaler — 2000)

» Even if we have a good plan we are terrible at sticking to it.

» Empirical work is clear: we are terrible at saying no to current gratification — decision fatigue.

» Retirement saving and investing is not passing up desert until the weekend — it is the ultimate long game.

"Investing is not a battle between you and the markets...it is a battle with yourself." — Ben Graham

SO WHAT CAN WE DO?

We have been doing this for a long time! — subsistence and cash crop rotation.

Commitment Devices WORK!

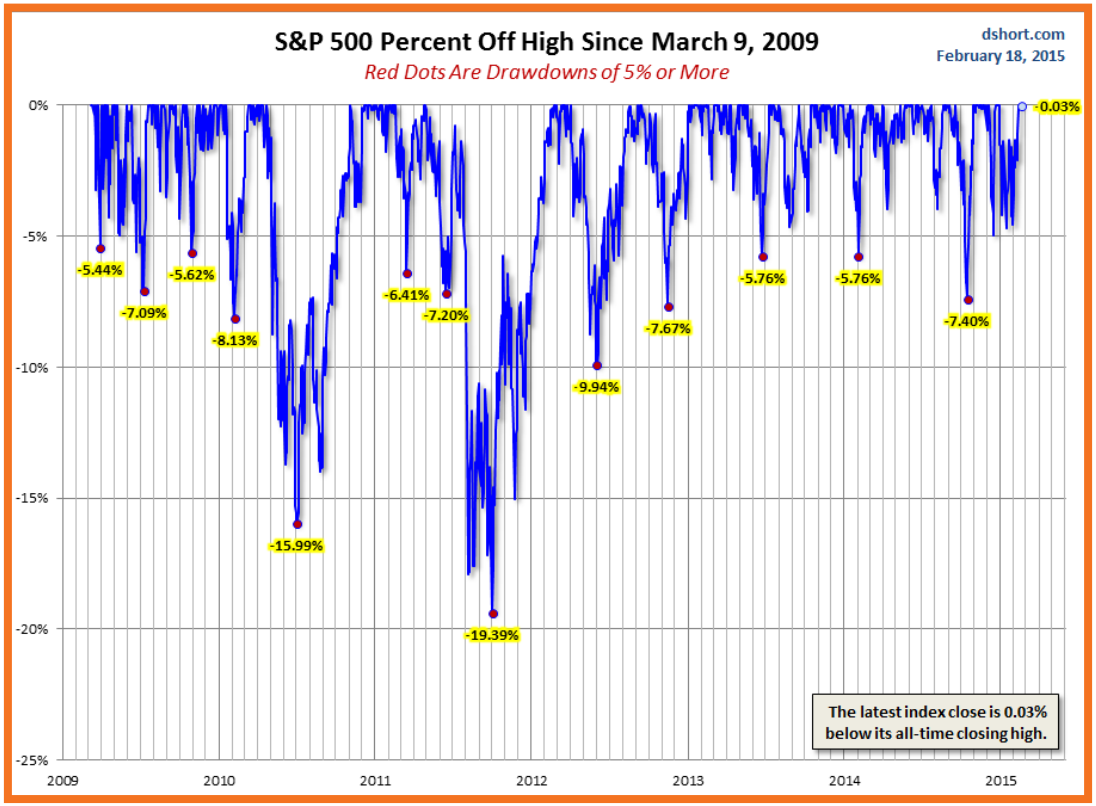
- The solution is not robo-investing, it is robo-savings.
- Opt-out versus Opt-in (401k participation is 4x IRA).
- Dollar Cost Averaging.
- Target/Life Cycle Funds.

We should obsess over savings, tax planning, debt minimization, and estate planning and NOT over comparative investment returns.

SO WHAT CAN WE DO?

Reframe!

Know thy Availability heuristic — show 10 and 20 year performance, not 1 and 3 year. People might be less scared of volatility if they knew how "normal" it is.



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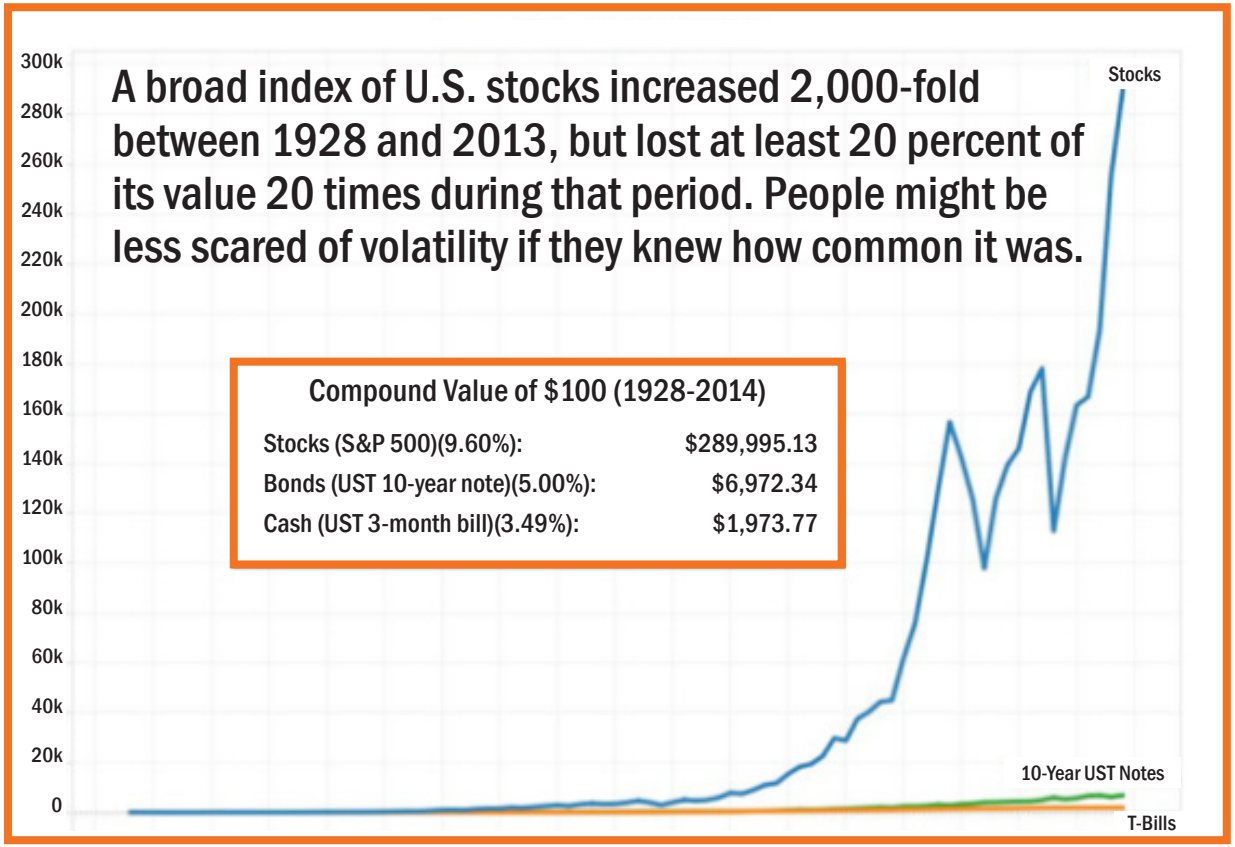

SO WHAT CAN WE DO?

Reframe!

- Know thy Availability heuristic — show 10 and 20 year performance, not 1 and 3 year. People might be less scared of volatility if they knew how "normal" it is.
- Reduce complexity — Paradox of Choice is statistically supported in retirement investment decisions.
- Framing almost always pushed people to take the lump versus the annuity, often to detriment of retiree.
- Reframe to "lifestyle and purchasing power maintenance" — not IRR and returns relative to S&P.
- Less choice, less lawyers, and more education.
- Help end younger people consistently investing too conservatively.
- More education earlier in schools: on savings and investment, time horizon, compounding, basic math skills.
- Somehow enable the fixed annuity to move from a fee-laden gift for the insurance industry to a cheap, commodity, "subsistence" product.

SO WHAT TO DO?

My Favorite — Kill Your Mental Account

- We anchor to "only spend income and don't touch principal."
- Should move toward the "Unitrust" of a fixed percentage withdrawal on a multi-year averaging of asset value basis.
- Enables "total return" investing, which is not only more rational, but helps negate our longevity risk.

OTHER MENTAL PROBLEMS ON AGING AND MONEY

- Hard to admit you don't know what you are doing — cognitive health or otherwise.
- Hard to delegate decision making.
- Inertia and procrastination.
- Expensive and emotionally difficult to set up Trusts that cede control.
- Legitimate fears that family and advisers have no idea what they are doing or are poorly-incented.
- Behavioral Nudges work on youth — elders need SHOVES.

LASTLY, YOUR GRANDFATHER WOULD TELL YOU:

Retirement offers more time to think, read,and do slow thinking, which is not only highly correlated with good investing results, but is rarely practiced. It's about eating, not being eaten.

Don't quit working.

Rich people need love too.

Ready to retire? Divide by two and then answer the question again.

Consider the non-zero probability your kids will continue to bankrupt you.

Second homes and private planes are the two leading causes of why very successful people can succumb to normal retirement problems.

Retirement is goal based investing, not benchmark based investing. No one is judging you, comparing you, benchmarking you, looking over your shoulder

You don't have the discipline you think you do:

- » Set up Trusts.
- » Start saving earlier.
- » Set up health directives and insurance early.
- » Avoid the winners effect — lean against the wind

You are never too old to understand that most financial products from wall street or the insurance industry are meant to be sold rather than purchased — there is no age limit to caveat emptor.

Turn off the damn CNBC.

"You gain more by not being stupid than you do by being smart. Smart gets neutralized by other smart people. Stupid does not."

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