

## Crosby, Dr. Daniel – The Laws of Wealth

Harriman House, 2016, [Equity Investing] Grade ★★★★★

This is something as unusual as a practical book on behavioral finance. Where the discipline for too long has focused on disproving the so-called Modern Portfolio Theory and listing psychological quirks among investors, Daniel Crosby takes things one well needed step further and applies the theories on real life investing.

The stated aim of Crosby – a psychologist by training that today is an asset manager and a well sought after speaker on behavioral finance – is to make the reader wealthier. The target audience is private investors and the thesis of Crosby is that knowing the behavioral investment traps will not help you to become a better investor. Since they are hard-coded in our brains an investor cannot escape them simply by knowledge and will power. Instead the investor like Odysseus must tie himself to the mast and construct rules that protect him from himself and by doing this he will fair much better than other investors that either don't know their behavioral biases or haven't shown the rigor to construct and follow such rules. Rules eat knowledge for breakfast to paraphrase Peter Drucker. I agree full heartedly with the thesis.

There are two main parts to the book. In the first 10 guidelines for behavioral self-management are presented. This is where the reader gets to acquaint himself with the psychological traps through a number of short chapters with names like *If You're Excited, It's a Bad Idea*, *You Are Not Special* or *Forecasting Is For Weathermen*. A consistent theme through this first part is that the world of investing is very special as most actions that are intuitive and work in other contexts actually lead the investor astray on the stock market. The human psyche is badly equipped to handle investments.

The second part presents a framework for a system that, if applied consistently, will “tilt probabilities in favor of the investor ever so slightly”. Small tilts like this will by the power of compounding over time build large fortunes. The author calls the framework Rules Based Investing (RBI) and as a

good psychologist brands the parts the 4 Cs of rules based investing and the 5 Ps of equity investing. They C's are: Consistency – follow your rules slavishly, Clarity – do a few important things well, Courageousness – stay invested in stocks but take a small part off the table when they are super expensive and Conviction – keep about 25 stocks in an equity portfolio.

The rules of equity investing are a bit force-fed to fit into words that start with a P so I'll present them more freely. Be a value investor as it both gives higher returns over time but also is a type of risk management. Invest in companies of some quality as it also protects the downside. That is: buy cheap and good rather than expensive and bad. Protect the downside by diligent risk management, follow how corporate managers invest their own money through their insider dealings and finally take account of momentum as well. The “Ps” are all connected in that they exploit others behavioral biases and as these are hard-coded they probably will not disappear. That doesn't mean that they work all the time – if they did they would probably be arbitraged away.

The author is wise, likable, well versed and witty and further without the set opinions that prevent many value investors from appreciating momentum. The language is well suited for any well-educated reader. You get the same feeling as in Ben Carlson's *A Wealth of Common Sense*, albeit with a more academic touch and more humor. Personally I think that the number of quotations and citations could have been less. As it is now you get a slight cut-and-paste feeling. For good or bad the reader is also left to fill in the details on how to be a value investor, exploit insider trading etc.

Today much of the behaviorally sound investment literature is directed towards private investors. It will be up to professional investors to apply the advice in an institutional setting. Most of all I'm thrilled that behavioral finance is finally, finally becoming an applied science.

Mats Larsson, June 27, 2016