Part 4 – Sometimes everyone else is wrong

A term often used to describe how people are influenced by other people and stimuli around them is herd mentality. It's not a particularly attractive phrase but perhaps that's because often the outcomes are not great.

We see herd mentality in many aspects of financial matters. In the share market the goal is to buy low and sell high but a plethora of studies on this topic across the globe have determined that most investors buy high and sell low.

It does not necessarily mean they lose money. If the shares have been held long enough it's likely the sale price will be higher than the purchase price as over time shares indices generally increase.

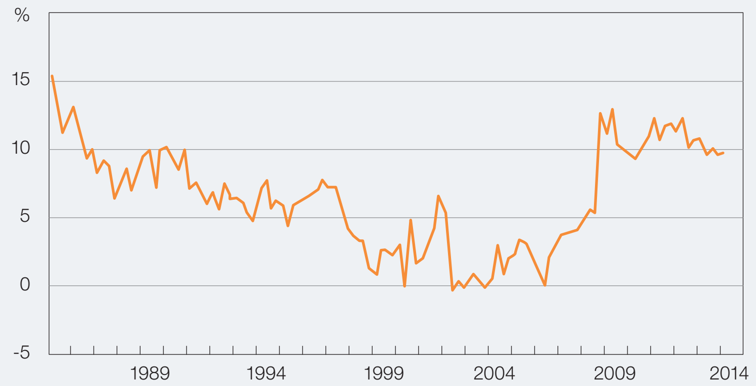
The point is many investors buy at a time when there is excitement in the market and everyone is piling in to get a piece of the action, and sell when times are depressed and worries set in that share indices will only fall further.

This herd mentality can also be demonstrated over a long time period by looking at the saving habits of Australians. The Reserve Bank of Australia tracks a number of interesting trends in our economy, of which one is the Household Saving Ratio.

We can see that household savings declined throughout the relatively stable economic cycle of the mid-1980's through to the mid-2000's, and even dipped into negative savings in 2003.

Household Saving Ratio*

Per cent of household disposable income



* Net of depreciation
Source: ABS

At the same time ABS data from a research discussion paper released in March this year showed household income has risen in a fairly stable manner since 1970 – although over the past couple of years it has plateaued as the economy continues to recover from the global financial crisis (GFC).

This graph also shows consumption rising since 1970 but the gap between household income and consumption narrowed during the solid economic growth period of the early 1990s to mid-2000s.

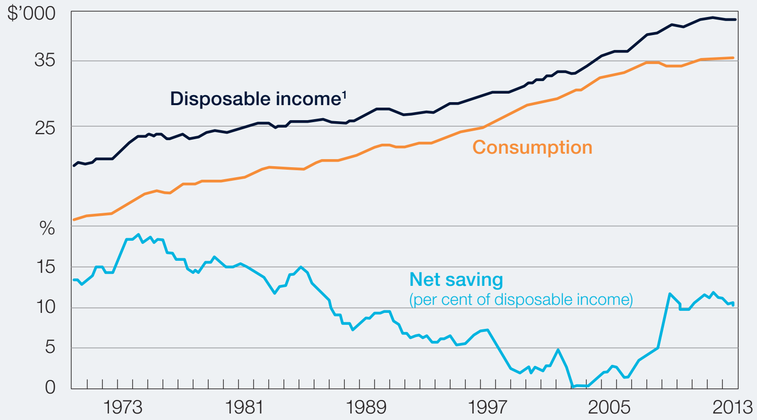
From a wealth adviser's viewpoint it's a pretty dismal picture. Income and consumption were rising and savings were falling.

It paints a picture of an Australian society that fell into a herd mentality and widely adopted the "want it now" balance sheet as discussed in Part 3 – What is your personal balance sheet?

While the data we have just reviewed shows many Australians could do more to utilise the benefits from their income it does not paint the full picture.

Household Income, Consumption and Saving

Per capita annual rolling sum



Notes: In 2011/12 dollars; deflated using the household final consumption expenditure implicit price deflator; disposable income and consumption are plotted using a log scale.

[1] After tax and net interest payments.

Sources: ABS; RBA

For instance, the Australian Securities Exchange released a Share Ownership Study in May last year that showed 38 per cent of the adult population held shares directly or through managed funds in late 2012. The figure was down from 54 per cent in the mid-2000's or pretty much the peak of our "want it now" period. So at a time when the gap between income and consumption was at its narrowest, and when savings were at zero, a record number of Australians were buying shares and adding to their asset base.

Interestingly the ASX study also found that the old mindset of "set and forget" – buy a portfolio of shares and stick it in the top drawer to be remembered years later – is a thing of the past. Investors are becoming more self-reliant about making investment decisions. But they have also increased their level of interest in seeking advice and information on their investments and its performance.

This feeds back into what we discussed earlier – that being involved in your wealth creation is a positive step but you don't have to do it alone, and your financial planner there to help with those decisions to achieve your financial goals and enrich your lifestyle.

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