

THE PSYCHOLOGY OF INVESTING

How Emotions Quietly Decide What Your Money Does

A Blog by SubbuS • Retired Banker

“The investor’s chief problem – and even his worst enemy – is likely to be himself.”

— Benjamin Graham, the father of value investing

After nearly four decades in banking, I can tell you a small secret: **investing is less about money and more about the mind**. I have watched brilliant, well-educated people make poor investment decisions, and ordinary savers quietly build wealth. The difference was rarely intelligence or information. It was **temperament** — the ability to stay calm when everyone around is either celebrating or panicking.

Markets are driven by numbers, but **investors are driven by emotions**. Prices of shares and bonds move every day, and with them move our hopes, fears, regrets and dreams. This branch of study — called **behavioural finance** — tells us that human beings are not the cool, rational calculators that textbooks assume. We are emotional creatures who happen to make financial decisions. In this article, let us understand, in simple language, how our own psychology helps or harms us as investors.

1. Fear and Greed: The Two Masters of the Market

It is often said that only two emotions really move markets: **fear and greed**. Everything else is commentary.

Greed whispers, “Everyone is getting rich, why not you? Buy more, buy quickly, borrow if you must.” **Fear** shouts, “You will lose everything! Sell now, run!” Both are survival instincts we inherited from our ancestors. They were excellent for escaping wild animals; they are terrible for managing a portfolio, because **they make us do exactly the opposite of what sound investing requires**: we buy when prices are high and sell when prices are low.

How Fear and Greed Make Us Buy High and Sell Low



Figure 1: The crowd typically buys near the top (greed) and sells or stays away near the bottom (fear).

“Be fearful when others are greedy, and greedy when others are fearful.”

— Warren Buffett

2. Why Are We Scared to Buy When Prices Have Bottomed Out?

Logically, a market bottom is a bargain sale. If you liked a good share at ₹500, you should love it at ₹250. Yet very few people buy at the bottom. Why?

- **Loss aversion:** Psychologists Daniel Kahneman and Amos Tversky showed that the pain of losing ₹100 is roughly twice as intense as the pleasure of gaining ₹100. At the bottom, the investor has usually just watched his portfolio bleed. The mind, desperate to avoid more pain, refuses to “catch a falling knife”.
- **Recency bias:** We assume that whatever happened recently will continue. If prices have been falling for months, the mind projects that fall endlessly into the future — “it will go down further, let me wait.” The wait usually ends only after prices have already recovered.
- **The snake-bite effect:** An investor who has just lost money becomes as wary as a person once bitten by a snake who now fears even a rope. Bad memories make him shun the very asset that is now attractively priced.

- **Absence of good news:** Market bottoms are always accompanied by terrible headlines — recession, defaults, job losses. Buying at the bottom means acting against every newspaper and every neighbour. That requires enormous courage, which is precisely why so few manage it.

Remember: **the point of maximum pessimism is usually the point of maximum opportunity** — but it never feels that way at the time. It feels like the end of the world. That is the trap.

3. Why Are We Tempted to Buy Big When Prices Are Skyrocketing?

Now consider the opposite situation. The market is at an all-time high, every channel is celebrating, your colleague has doubled his money, and your barber is giving stock tips. This is when most people feel **safest** — and invest their biggest amounts. The psychology behind it:

- **FOMO — the Fear of Missing Out:** Watching others get rich while we sit on the sidelines is emotionally unbearable. Envy is a more powerful motivator than logic. We do not just want to make money; we cannot tolerate others making money without us.
- **Extrapolation:** The mind draws a straight line from the recent past into the future. If a stock has gone from 100 to 300, we assume it will go to 900 — forgetting that the cheap purchase was available at 100, not at 300.
- **Social proof:** “So many people are buying — they cannot all be wrong.” Actually, they can. In fact, at market tops, they usually are.
- **Overconfidence:** A rising market makes everyone feel like a genius. We attribute lucky gains to our own skill and take bigger and bigger risks — exactly when risk is at its highest.

The irony is complete: **the same investor who found shares “too risky” at the bottom finds them “safe” at triple the price.** Price and risk move together, but our feelings about them move in opposite directions.

The Cycle of Market Emotions

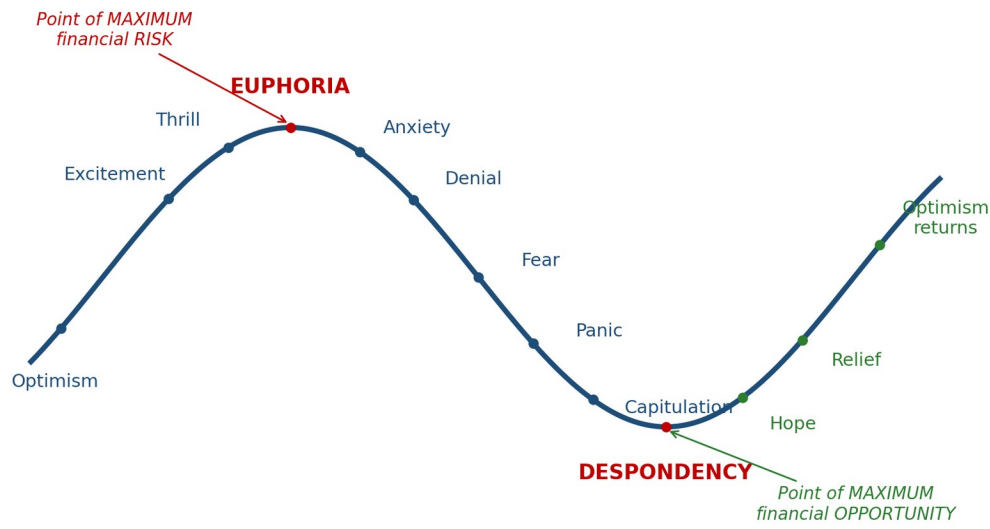


Figure 2: The emotional roller-coaster every investor rides. Euphoria is the point of maximum risk; despondency is the point of maximum opportunity.

4. Herd Mentality: The Comfort of the Crowd

Herd mentality is the tendency to copy what the majority is doing, instead of thinking independently. Humans are social animals; for thousands of years, staying with the herd meant safety, and being alone meant danger. That ancient wiring is still inside us.

In investing, the herd instinct shows up everywhere: everyone rushes into the same “hot” sector, the same IPO, the same cryptocurrency — not after studying it, but simply **because everyone else is doing it**. Following the herd also gives us an emotional insurance policy: if I lose money along with everyone else, it does not feel like my personal failure. As the saying goes, misery loves company.

But here lies the problem: **the herd is most confident precisely when it is most wrong**. Every bubble in history — from the Dutch tulip mania of the 1600s to the dot-com boom of 2000 to countless property and crypto frenzies — was a herd running happily towards a cliff. And every crash bottomed out when the herd, exhausted and disgusted, finally gave up and sold.

“You are neither right nor wrong because the crowd disagrees with you. You are right because your data and reasoning are right.”

— Benjamin Graham

5. Why Do We Think Short-Term Instead of Long-Term?

Ask any investor whether compounding over 20 years builds wealth, and he will agree instantly. Yet the same person checks his portfolio five times a day and feels an urge to “do something” every week. Why is long-term thinking so hard?

- **Present bias:** The human brain values a reward today far more than a bigger reward tomorrow. Offered ₹100 now or ₹150 after a year, most people grab the ₹100. Our ancestors lived in a dangerous world where the future was uncertain — “eat the fruit now” was sound survival advice. It is poor investment advice.
- **Instant gratification culture:** We live in an age of instant coffee, instant messages and one-day delivery. Waiting a decade for wealth feels almost unnatural when everything else arrives in minutes.
- **Myopic loss aversion:** The more frequently you check your portfolio, the more often you will see temporary losses — and each sighting inflicts pain. This pain pushes investors to cut short exactly those investments that needed time to flower.
- **The visibility trap:** Short-term action is exciting and visible; long-term patience is boring and invisible. Nobody narrates at a dinner party, “I did nothing to my portfolio for ten years.” Yet that boring sentence describes most successful investors.

“The stock market is a device for transferring money from the impatient to the patient.”

— Attributed to Warren Buffett

6. The Lure of Quick Money

Why do lotteries flourish even though almost everyone loses? Why do people chase penny stocks, day trading and “double your money” schemes? Because the brain is wired for it.

Neuroscience tells us that the anticipation of a big, quick reward releases **dopamine** — the same chemical involved in gambling and other addictions. The thrill is in the chase, not the arithmetic. Add to this **overconfidence** (“others

may lose, but I am smarter”) and the **lottery mindset** (overweighting tiny probabilities of huge gains), and you have a perfect recipe for ruin.

Quick money also seduces because slow money is invisible. Compounding at a steady rate looks unimpressive for years — and then, suddenly, it looks like a miracle. Einstein is often quoted (perhaps apocryphally) as calling compound interest the eighth wonder of the world: **he who understands it, earns it; he who doesn't, pays it.**

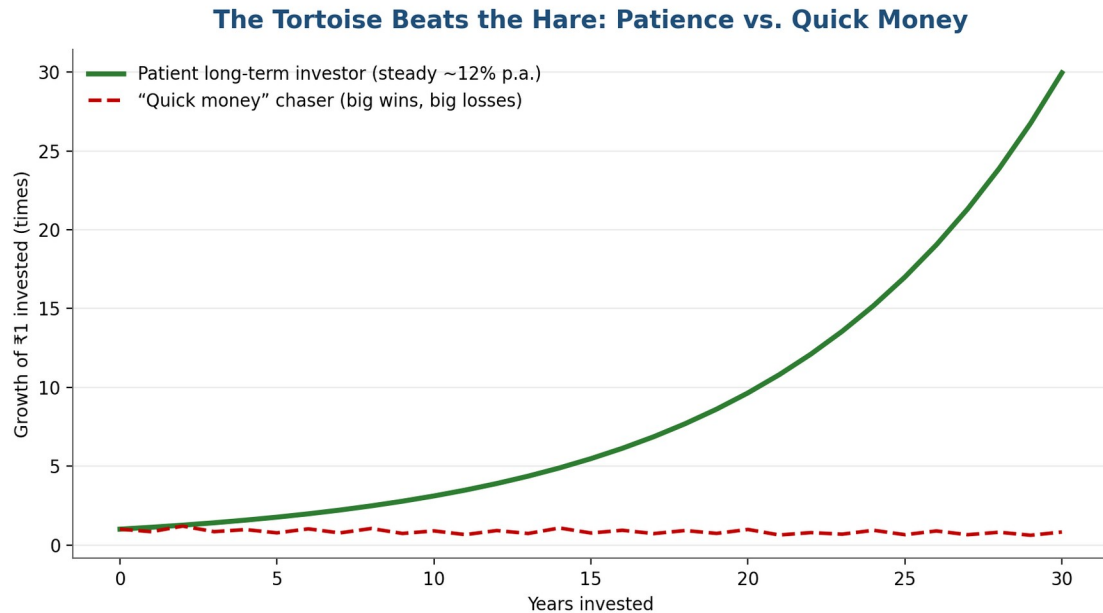


Figure 3: An illustration — the patient compounder ends up far ahead of the quick-money chaser whose big wins are repeatedly wiped out by big losses.

7. A Quick Tour of Other Mental Traps

- **Anchoring:** Clinging to a reference price — “I bought at ₹800, I will sell only when it comes back to ₹800” — as if the market knows or cares about your purchase price.
- **Confirmation bias:** Reading only the news that supports what we already believe, and ignoring every warning sign.
- **Mental accounting:** Treating dividend money, bonus money or “profit” money as free money to be gambled, while guarding “capital” carefully. Money is money; it deserves the same respect wherever it came from.
- **Sunk-cost fallacy:** Holding on to a bad investment simply because we have already lost so much in it — throwing good money after bad instead of asking, “Would I buy this today?”

- **Endowment effect:** Overvaluing what we already own. Investors routinely refuse to sell an inherited or long-held share at a fair price merely because it is “theirs”.

8. Taming the Mind: Practical Lessons from an Old Banker

Knowing the traps is half the battle; building fences around them is the other half. Some time-tested fences:

- **Write an investment plan** — your goals, asset allocation and rules — when markets are calm, and follow it when they are not. A plan made in peace protects you in panic.
- **Automate your investing.** Systematic, regular investing (such as SIPs) removes emotion from the buying decision. You automatically buy more units when prices are low and fewer when they are high.
- **Turn down the noise.** Check your portfolio once a quarter, not once an hour. The less often you look, the wiser you will behave.
- **Keep an emergency fund and adequate insurance.** Fear grips hardest those who have no cushion. Safety money buys courage.
- **Never invest borrowed money or money you will need soon.** Leverage converts ordinary fear into panic.
- **Ask the reverse question.** When everyone is buying, ask “What can go wrong?” When everyone is selling, ask “What can go right?”
- **Judge yourself by process, not outcome.** A good decision can have a bad short-term result and vice versa. Discipline, diversification and patience form the process; wealth is merely the by-product.

9. Closing Thoughts

Markets will always swing between greed and fear — that is their nature. Our job as investors is not to predict these swings but to **refuse to participate in the madness**. The investor who understands his own psychology holds an advantage that no stock tip can match.

Wealth creation, in the end, is a test of character conducted through the medium of money. The market does not defeat us; **we defeat ourselves** — and therefore, we can also save ourselves. Invest regularly, stay diversified, think in decades, and let compounding — the quiet, patient servant — do its work.

“Success in investing doesn’t correlate with IQ. What you need is the temperament to control the urges that get other people into trouble.”

— Warren Buffett

— SubbuS (Retired Banker)

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