

The Grandfather of Behavioural Investing?

Benjamin Graham is considered by many as a founding father of value investing. Upon a re-read of the seminal Security Analysis¹, which he and David Dodd first published in 1934, one learns that many of Graham's insights were not simply confined to balance sheets and income statements. In fact, he devoted a significant effort to such topics as psychology, overreaction, under-reaction, and the consensus view. As such, in addition to being the father of value-investing, Graham is also a very important ancestor to today's behavioral economists.

On psychology and investing...

"Investment theory should recognize that the merits of an issue (i.e. stock) reflect themselves in the market price not by automatic response or mathematical relationship but through the minds and decisions of buyers and sellers." (p. 12)

"...the market is a voting machine, whereon countless individuals register choices which are the product partly of reason and partly of emotion." (p. 23)

"The main obstacles to the success of the analyst's work are threefold; (a) the inadequacy or incorrectness of the data, (b) the uncertainties of the future, and (c) the irrational behavior of the market." (p. 20)

"Evidently, the processes by which the securities market arrives at its appraisals are frequently illogical and erroneous. These processes are not automatic or mechanical, but psychological, for they go on in the minds of people who buy or sell." (p. 585)

"The prices of common stocks are not carefully thought out computations, but the resultants of a welter of human reactions. The stock market is a voting machine rather than a weighing machine. It responds to factual data not directly, but only as they affect the decisions of buyers and sellers." (p. 452)

"The mistakes of the market are the mistakes of groups or masses of individuals. Most of them can be traced to one or more of three basic causes: exaggeration, oversimplification, or neglect." (p. 585)

On the disposition effect, intermediate-term underreaction, and even short-term overreaction:

"There is inertia to the typical investor. He buys by reputation rather than by analysis and he holds tenaciously to what he has bought." (paraphrased, p. 598)

"At times some specific development greatly strengthens the position of a (company), but the (stock) price is slow to reflect this improvement, and thus a bargain situation is created." (p. 593)

"Undervaluations caused by neglect or prejudice may persist for an inconveniently long time, and the same applies to inflated prices caused by overenthusiasm or artificial stimulants." (p. 22)

"Standard or leading issues (blue-chips, large caps, etc.) almost always respond rapidly to changes in their reported profits – so much so that they tend regularly to exaggerate marketwise the significance of year-to-year fluctuations in earnings." (p. 588)

"...guard against overemphasis upon the superficial and the temporary" (preface viii)



Grandfather Graham

¹ Dodd, David, and Benjamin Graham, 1934, Security Analysis, McGraw-Hill

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