Philequity Corner (August 4, 2014)
By Antonio R. Samson

Hoping Mechanism

Behavioral economics and its growing list of practitioners, including a Nobel prize winner like Daniel Kahneman, combine the disciplines of economics and psychology (what motivates us to buy or invest) have first been the rage, and then lately been knocked around. In his well-argued book with a long sub-title, “Psychonomics: How modern science aims to conquer the mind and how the mind prevails” (2014), Eric Robert Morse dissects the various studies that purport to show that the rational economic man (Homo Economicus) no longer exists, if he ever did. This construct of classical economists shows the consumer to be fully knowledgeable and rational moved only to make the most optimum decision that the numbers lead him to, without any ounce of emotion.

The behavioral economists then went overboard to show the emotional side of decision-making like peer pressure, status anxiety, panic buying, and going overboard for freebies. Eric Robert Morse in his book restores the balance of rationality and evaluates the surveys and experiments conducted by the behaviorists. The researches, on which the conclusions of recurring “irrationality” were based, dealt mostly with artificial choices offered to subjects using samples mostly drawn from students in the universities where the professors of behaviorism worked. This bias did not adequately reflect the real population and Morse as a scientist would have preferred field work and random selections.

Still, the impact of “how the mind really works” is not denied. The emotional content of economic decisions can be significant, but this right side of the brain in making purchases cannot be dismissed as merely irrational. Daniel Kahneman’s work considers the two sides of the brain in “Thinking, Fast and Slow” (2011). The fast thinking involves intuition and instinct as when driving to work in a familiar route. The slow thinking involves reading a map (or following a GPS) to a new destination requiring analysis and option-selection.

Where is all this unnecessary display of erudition leading to? (Be patient, Constant Reader.) This will somehow be connected to the economy and the stock market…or maybe not.

Still, economists even before behaviorism took root, explained the increase in consumer spending during a bull market, which is more or less what we have now albeit involving a small snorter, as part of the “wealth effect.” When paper (and yet unrealized) profits pile up in one’s stock portfolio, the emotional feeling of wealth sets in. This leads to some exuberance of feeling rich with the rise in the consumption of luxuries like Jaguars, condo units, couture clothes, jewelry, body scrubs with Dead Sea salt, and trips to Amsterdam. Thus, just the feeling of being wealthy can drive consumption, even if fueled by credit card spending.

This wealth effect has a flip side. What if the stock market experiences a correction, does one feel poorer and experience what may be called a “poverty effect”? Will the Ukrainian plane crash, quantitative easing reduction, the prospect of a rise in inflation and interest rates, and the butting of heads between the two branches of government result in a sell-off and a downward pressure on the price of stocks and bonds? The answer is an emotional one. Even when corporate profits are healthy, there may be a “gut feel” that cash again needs to be conserved. Paper profits are locked in.

Whining may rise, first from the usual prophets of doom who haven’t met a conspiracy they don’t want to shake hands with, then with formerly level-headed opinion makers. There is little appreciation for actual positive numbers including the upgrading of the sovereign credit rating. (Still remember that one?) Property marketers start using the malls to give away brochures on unsold inventory. Pre-selling of condo units on a three-year delivery are not stoking interest, as seen from their flat prices, even with low interest rates which anyway may not hold for long.

Days’ receivables of supplier companies get longer. Even large corporations hang on to cash and stretch their payments to the detriment of small suppliers like janitorial services and construction companies. This postponement, if not deep discounting, of the payment of bills creates the illusion of having more cash on hand from de facto suppliers’ credit. Suppliers who hit back by requiring higher payments up front and requiring post-dated checks lose their competitiveness and attractiveness to the big (but slow-paying) corporate buyers.

Still, even the market which thrives on hope can have a wait-and-see attitude which is described by analysts as “taking a breather” with investors on the sidelines, sipping their cafe latte’. This caution usually follows the departure of hot money, when foreign investors are “net sellers” opting for the safe havens of the home markets which continue to set record index levels.

The poverty effect dents consumer confidence. True, the inward remittance of the OFWs continues to drive up consumption. These overseas workers now see their foreign currency wages buying more pesos and consumer goods for their dependents at home.

Can the hoping mechanism be harnessed to restore a little of the wealth effect?

Business swings involve an outlook and a mood. Since an oil strike, the opening of a major new plant by a foreign company, or the addition of flights in over-burdened airports are not easy to arrange, some other kind of psychological lift is needed to perk up the economic mood. Sometimes speeches from the once-effective chief cheerleader bumped up the index. The recent pulpit outing has not made the galleries watching the game stand up in rhythmic applause and encouraging shouts for the home team.

It’s not a matter of getting a new cheerleader, but maybe a new set of drums and newer exhortations. In the matter of hope, the cheering can affect the game, as it surely does even in basketball. (Let’s not go there.) Still, as an aside, hope and despair are easily understood in the ballgames, depending on the team one is cheering for. The jeering squads for those teams with a bad win-loss start (where the latter is higher than the former) are the ones fond of changing the coach, or at least talking about it.

Preventing a poverty effect to finally take root entails showing more than GDP numbers and the usual economic metrics. There is an emotional component similar to a newly wealthy individual feeling comfortable in his new and bigger house. It’s a sense of belonging to the club of successful emerging economies.

The social climber may be an object of scorn in the teleserye by attempting to belong in the company of wealthy even if she can't even afford cab fare. Still, the motivational speakers will tell you that "visioning" (imagine yourself in a yacht) in this case aspiring to belong to the rich economies can be a self-fulfilling prophecy. Hope can be an engine of development. It's a matter of choosing the numbers to highlight. After all, there is indeed some basis for the optimism.

Setting aside perhaps one month, maybe longer, for media to highlight only positive news in a novel type of enterprise reporting is a good place to start—digging for the gold rather than looking for the rust. A daily dose of good news can start us believing that things are really going right. The wealth effect does not need to be material, it can start with a spirit of celebration—an economic demonstration of the middle class believing in the success of our country.

It may mean doing away with talks of unseating leaders and re-opening investigations of all sorts of anomalies, including those involving canceled deals and spoiling other people's birthday celebrations.

Is the hoping mechanism effective? Maybe, it's time to introduce the impact of optimism in achieving success. We haven't yet tried the "hope effect." It can be as contagious as pessimism…and a bit more productive.

Philequity Shareholders' Meeting

We would like to invite our clients and investors to the Philequity Shareholders' Meeting. This will be held on Saturday, August 16, 2014, 9:00 am at the Meralco Main Theatre, Meralco Center, Ortigas Avenue, Pasig City. The discussions will focus on explaining how our fund manager thinks and how he navigates through the bear and bull cycles. We will also have an investors briefing where our analysts will present our outlook for the stock market. Please register by sending your name and contact # to events@philequity.net.

Please visit our online trading platform at www.wealthsec.com or call 634-5038 for detailed stock market research. You can also visit www.philequity.net to learn more about the Philequity Fund and view our archived articles. You can email us at feedback@philequity.net for feedback on the Philequity Corner articles.