

**Presenting  
debate on  
contemporary  
and emerging  
portfolio  
construction  
issues**



portfolio  
construction

CONFERENCE

15 & 16 August 2007 | AJC Convention Centre, Randwick, Sydney

[ Portfolios ]

**I've been thinking about...  
when to buy/hold/sell**

Presentation

**I've been thinking about...  
identifying skill and behavioural  
weaknesses in active  
management**

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portfolio  
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# I've been thinking about... identifying skill and behavioural weaknesses in active management

**Alessandro Lunghi**

**Presentation to  
PortfolioConstruction Conference 2007**



## Timing Skills: Theory v Practice

When choosing which stocks to sell:

- Conventional wisdom suggests managers should cut their losers and run the winners
- But they don't, they do the opposite
- And it hurts

## Evidence: Do Managers Sell Winners?

Majority of stocks sold had been “winners”

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Prior 12 months

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Outperformed	57%
Underperformed	43%

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## But “Losers” Over 1 Month

But underperformed in prior 1 month

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	Prior 1 month
Outperformed	46%
Underperformed	54%

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## Now Looking Forward

Stocks sold subsequently outperform

6 months	12 months
1.9%	3.0%

## Impact on Portfolio Performance

Annualized impact of sales on performance  
(bps)

Sells
-94

- Pioneering proprietary attribution analysis of timing skills
- Capturing very significant drag on performance
- Wide dispersion of results



## But Managers Do Have Timing Skills

Annualized impact of purchases on performance  
(bps)

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Buys
47

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- Buys add value
- But more than offset by sells

## So Why Is It?

- Behavioural Finance explanations:
  - Prospect theory
- Inalytics experience:
  - Sell decisions tend to be researched less

# Behavioural Finance Literature

## Prospect theory

- When looking at profits investors:
  - Prefer smaller profits to riskier gains
  - Leads to top slicing and profit taking
- When looking at losses investors are:
  - Reluctant to crystallize losses
  - Prepared to run the risk of greater losses

## Inalytics Experience

Sell decisions tend to be:

- Not as well researched
- Cash raising for latest buy idea

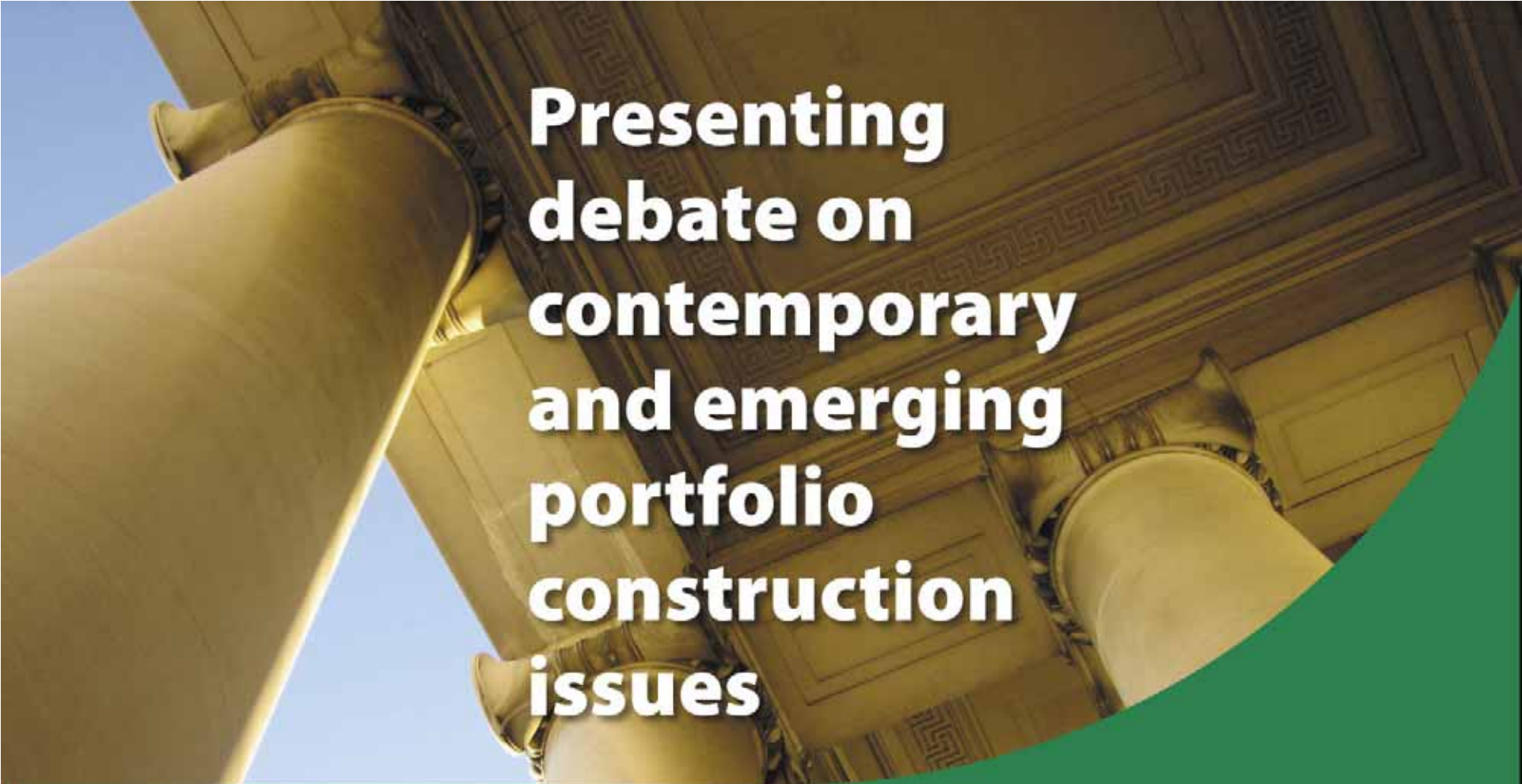
Good sellers are a rare breed:

- Cynical, and always looking for the "catch"
- Tend not to fit

## Too Important to Ignore

- Managers do have timing skills
- However are offset by behavioural biases
- Resulting in a significant loss of value

*"If you do not know who you are, markets are an expensive place to find out" Adam Smith*



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