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Irrational Optimism

When investing in a stock there are usually a few questions an investor would ask themselves. The first one would be: Will I make money? If the answer is yes, then how long will it take? Now is it possible to say that if you keep an investment for 20 years or more, it will always make you money? Common sense would say that for a stock to be profitable in the long run, it would depend on the market conditions, the company's current situation and the environment at the time. It does not seem ideal for an investor to believe that no matter what investment or what country invested in as long as you keep it for a certain amount of time the stock in hand will turn a profit. But oddly many investors believe in this irrational way of thinking.

The article Irrational Optimism by Elroy Dimson, Paul Marsh and Mike Staunton looked at the US and other countries financial markets and compared all the historically earnings to the length of time a stock could be held. By doing so they were able to see how a stock would perform if held for 10 years, 20 years, etc. The authors compared what they found in the US to other countries. They saw that by keeping an investment for long-term or the idea that stocks are safe so long as they are held for 20 years or more is untrue. Although in some cases keeping an investment for a long time would be beneficial, in most cases it depends on what market the stock is in and the events that happen in the market while the investor has the stock.

The authors found an interesting fact while doing the research. If an investor would diversify their investments, meaning they would invest their money in

different countries with different economies, they would have a lower risk on their investments and would have a greater chance to profit in the long run. This seems to be the ideal scenario for an investor because their eggs are not all in one bucket. If something happens in one economy it does not affect the rest of investor's investments. The only problem is that in the past there were many trade barriers and high taxes, which would make it difficult for someone to greatly diversify their portfolio. Today, many of these barriers have been removed but investors still tend to invest in their domestic economies.

With risk comes reward. This is a very important statement in business. The greater amount of risk, the more an individual would want to gain from it. No normal person would take a large risk without the opportunity to make a lot of money. There is no easy way to make money. The belief that long term 20 year and over investments are a sure thing is extremely false. The idea of Investors who believe about future long run profits without a strong argument are irrational and should not be followed. Investing in the stock market or other financial products should always be studied with extreme scrutiny. Depending on the irrational belief that eventually the price will go up is wrong and should never be followed.